Investor Group on Climate Change

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Committee Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

Dear Committee Secretary,

The Investor Group on Climate Change Australia/New Zealand ('IGCC') would like to thank you for the opportunity to comment on the Carbon Pollution Reduction Scheme Bill 2009 and related bills. This submission addresses changes announced by the government to the Draft Pollution Reduction Scheme Bill 2009 (CPRS Bill) on May 4th and provides comments on the CPRS Fuel Credits Bill.

Introduction

IGCC supports the introduction of the CPRS and supports its early passage through the parliament.

IGCC represents mainstream Australian investors, with total funds under management of over $500 billion, and other key participants in the investment community. Members of IGCC invest in all sectors of the economy, emissions-intensive and low-emissions alike, and are part owners of most of Australia's large companies. IGCC accepts the science of climate change and considers that prudent management of related investment risks is the only responsible course of action for institutional investors.

IGCC members have the capacity to reallocate capital to address shifting economic circumstances and emerging investment opportunities over the long-term. Where sudden economic adjustments usually lead to loss of investment value, steady economic transitions allow for reallocation of capital in a staged way, thereby minimising investment loss. Because we believe that significant economic adjustment will be necessary over the long term as a result of and in order to address climate change, IGCC is concerned to ensure as smooth an economic and investment transition to a low-carbon economy as possible.

The prospect of further delays to scheme commencement along with high emissions reduction targets in 2020 is of significant concern to the IGCC. In combination, a delayed scheme start and high emissions reduction targets will lead to greater volatility in investment markets and in the Australian economy. An early start to emissions trading in Australia is one step we can take as an economy to mitigate a more volatile economic transition in the future.

In addition to longer-term concerns, a stalling in scheme commencement is stalling investment decisions across the economy today. Existing emissions-intensive assets require clear plans for their utilisation and development. These plans cannot be resolved until the timing and extent of carbon price impact can be clarified in investment models. Until a clear start date for emissions trading is set by the parliament, both debt-financing arrangements for these emissions-intensive assets and companies, and investment activities to support them will be delayed.

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Institutional investment in large-scale clean technologies and new energy opportunities will also be affected if a price signal is not operating in the market. As investors of the savings of others (in most cases the superannuation savings of Australians) institutional investors will not be in a position to support large-scale low-emissions technologies and businesses without a clear investment proposition. A price on carbon is a necessary input to this investment proposition. IGCC recognises that complementary policies such as the Renewable Energy Target also support commercialisation of low-emissions technologies.

The consequence of continued uncertainty around the timing of scheme commencement is, therefore, delayed investment in both emissions-intensive and low-carbon businesses and is also an effective break on investment and economic recovery.

While IGCC has some outstanding concerns regarding CPRS design, it believes the way to address these is through amending legislation after the CPRS is passed. Introducing this legislation and establishing the framework for carbon pricing in the economy is the most important step to take and should be taken now.

With the above comments in mind, IGCC puts the following views on the Government's recent changes to the CPRS Bill.

A delay in the start date of the Scheme of one year to July 1, 2011

IGCC favoured a commencement date for the CPRS of July 1, 2010. This is because IGCC is concerned to avoid undue volatility in the carbon price trajectory over the period of transition to 2020. Shortening the available time period to achieve possibly increasing emissions reduction targets increases the risk of market and economic volatility. IGCC now strongly encourages the government to start the CPRS not later than July 1, 2011.

On the issue of investment certainty, IGCC submits that parliamentary endorsement now of CPRS scheme commencement in 2011 will provide the necessary clarity to investment markets for current and near term investment decisions.

A one-year fixed-price period in 2011-12 of $10 per tonne of carbon

IGCC sees potential long-term costs for a smooth economic transition and short-term benefits for investors from a fixed price for emissions permits of $10 per tonne in the first year of the CPRS. While IGCC does not favour a fixed $10 permit price, this is not sufficient reason to delay the CPRS.

IGCC considers that a fixed permit price constrains the efficiency of the market in finding lowest cost emissions abatement by potentially under-pricing the economic costs of carbon emissions. A fixed price makes it more difficult for investors to determine the true valuation impacts of a carbon price on their investments but the impact on valuation modelling will not be not be significant. Additionally, the fixed permit price, along with unlimited permit supply, represents a further delay in the transition to low-carbon business activities and investment opportunities. The effect is a distorted and slowed economic transition now and the prospect of greater market volatility in later years.

A fixed permit price will give investors additional investment certainty in terms of the short-term carbon liabilities of certain companies. While this may be welcome as a short-term influence on investment decisions, it is outweighed in its impact by further delay in full functioning of emissions trading.

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Assuming the Government continues with a fixed permit price in the first year of the scheme, IGCC strongly endorses an approach that prevents permits from being banked or borrowed during the fixed price phase. This will limit the distortionary affect of the fixed permit price.

An increase in the assistance for EITE's

IGCC supports compensation for EITE companies as a transition arrangement.

Based on research by IGCC members Goldman Sachs JBWere[1] and Citi Investment Research[2] on the top 100 listed companies in Australia, IGCC believes that compensation to EITE companies will result in minimal financial impact on these companies in the short to medium term. IGCC believes the extension of compensation levels means that existing investors in these companies will receive sufficient protection to avoid capital flight in the early years of the scheme.

IGCC endorses provisions requiring that EITE assistance should cease if an international agreement to limit global emissions is reached, and Australia's major trading partners agree to significant and comparable emissions reductions measures.

Funding for eligible businesses to undertake energy efficiency measures

IGCC supports the provision of funding for eligible businesses to support energy efficiency measures.

A commitment to reduce carbon pollution by 25% of 2000 levels by 2020 if global agreement to stabilise levels of CO2-e at 450 parts per million or less is reached

IGCC supports the extended target of a 25% reduction in emissions over 2000 levels in the context of a global agreement in which other industrialised economies take on comparable per capita emissions reductions targets.

IGCC believes that higher emissions abatement targets will be difficult to achieve through domestic action alone in the short to medium term and will make Australia dependent on emissions reductions permits sourced overseas.

Government purchase of international credits for up to 5 percentage points of the of the 25% target commencing no earlier than 2015

In the interests of a smooth economic and investment transition to 2020, IGCC supports provisions that allow the purchase of international credits by the government if necessary, but only in the context of a global agreement and emissions reduction target of 25% for Australia.

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[1] *ESG – Carbon Trading Update: Government announces delays to carbon pollution reduction scheme*. Goldman Sachs JBWere Investment Research, May 4th, 2009.

[2] Evidence to the Senate Select Committee on Climate Policy, Elaine Prioir, Citi Investment Research, Wednesday May 20th, http://www.aph.gov.au/hansard/senate/commttee/S12084.pdf

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Increased 2050 targets for Australia on the basis of an ambitious global agreement

IGCC supports the revision of 2050 targets for Australia following resolution of an ambitious global agreement on emissions reductions.

Establishment of Australian Carbon Trust

IGCC has no objection to the tightening of economy-wide emissions reductions targets based on post 2009 household Green Energy purchases.

In addition to the changes announced by the government on May 4th, IGCC highlights earlier a number of earlier positions on the on the CPRS Bill.

As mentioned above, there are some design features of the CPRS that IGCC does not support.

However, IGCC is of the view that the passing of the legislation should not be blocked, nor the introduction of the Scheme be further delayed due to disagreement in relation to various aspects of the Scheme. Rather, the legislation should be introduced and should contain sufficient provision for the review and amendment of the Scheme once it is in operation, to ensure it is efficient and effective.

Design features which IGCC believes should contain sufficient provision for review and amendment once operational, are described below.

Liable entities and covered emissions

IGCC retains its concerns about the exclusion of some industries and activities from the CPRS, specifically agricultural emissions and transport via fuel subsidies. Excluding some industries from the CPRS provides for an inefficient carbon price impact on the economy. As IGCC members invest in all sectors of the economy, any carbon price protection that is enjoyed by one sector of the economy will result in a burden for emissions reductions and therefore a greater price impact elsewhere in the economy and therefore on other investments. IGCC also believes that it is generally important to include industries in the scheme to prepare them for a more carbon-competitive future.

We do not believe the scheme should be delayed because of the exclusion of agricultural emissions and transport via fuel subsidies. We accept the inclusion of reforestation activities as carbon permit generating activities from July 1, 2010. IGCC prefers that scheme commence and that these industries are brought fully into the scheme as soon as is practicable.

Scheme caps, gateways and emissions units

Major investment decisions require long range planning and analysis and as such rely on market certainty. This is recognised by the objective of providing future scheme caps and gateways, which is to ‘provide a degree of market certainty’.

IGCC recognises that until international emissions reduction obligations under the United Nations Framework Convention on Climate Change have been established 5 year scheme caps may be appropriate. However, once international obligations have been established IGCC believes that the objective to ‘provide market certainty’ can best be achieved with 10 year scheme caps.

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Therefore, the legislation specifying scheme caps should include provisions to allow the possibility of 10 year scheme caps (and gateway at least 10 years beyond scheme cap). This would ensure that the draft legislation 'is designed to provide the maximum feasible level of certainty'.

Allocation of units – introduction, auction and fixed charge units

Fixed charge units

IGCC retains concerns about the proposed price cap in the form of access to an unlimited store of additional Australian emissions units, issued at a fixed charge, for the first five financial years of the CPRS.

Entities have the ability to manage and spread permit costs through the provision for banking and borrowing of permits. Further, the import of emissions units will also assist entities to manage permit costs (where the price of international permits is less than the price of Australian permits). These factors will also limit the degree of price shocks in the permit market.

IGCC is of the view that the problems created by providing access to an unlimited store of additional Australian emissions units, issued at a fixed charge will outweigh the benefits. In particular, the price cap will create inefficiencies by interfering with the free workings of the permit market. Fixing the maximum permit price has the potential to slow the necessary transition of the Australian economy to a low-emissions economy. For example, the proposed permit price cap is unlikely to provide sufficient incentive for fuel switching from coal to gas and the development of carbon sequestration technology. Depending on gas prices, the capped prices may not provide the incentive for the development of base-load CCGT that will be essential if the structural change in the electricity generation sector, which is needed for Australia to undertake any significant domestic abatement is to be achieved.

Should access to an unlimited store of additional Australian emissions units, issued at a fixed charge be retained in the CPRS legislation it is necessary for the identity of recipients and the number of units issued at a fixed charge to be more clearly and regularly published (as part of the public information provided under Part 12 of the Bill).

IGCC advocates for provisions in the legislation to amend or remove the fixed charge units should the operation of the CPRS result in the issues identified above.

Emissions-intensive trade-exposed (EITE) assistance program

IGCC agrees that there is a need for transitional assistance for EITE entities to avoid carbon leakage and believes that the proposed scheme will achieve this.

IGCC retains concerns about the arbitrary nature of the thresholds above which assistance is provided and the selection of 'activities' for which assistance is provided. The risk of unequal treatment of industries and activities is a focus by industry groups on achieving more favourable treatment for their own industry relative to others and not a focus on reducing emissions intensity. The granting of different compensation levels leads to inequities in CPRS impact and inefficiencies in the market. As investors across the economy, different compensation levels do not protect investors from the economic impact and potential investment loss associated with a transition to a low-carbon economy.

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Coal-fired electricity generation

Regarding assistance to coal fired energy generators, it is important to note that investors will support high emissions-exposed assets for as long as there remains an investment case to do so. IGCC does not advocate ongoing financial support to coal fired generators, but cautions governments that private investors will not maintain investment support for emissions-intensive generation assets if no financial return can be gained. Governments should therefore assess energy generation requirements across the economy and the likely availability of alternative energy generation sources when finalising assistance to coal-fired generators.

IGCC members accept that appropriate carbon abatement technologies, such as Carbon Capture and Storage will need to be proven and commercially available to maintain the operation of coal-fired generation assets over the long term. IGCC is of the view that direct assistance included under the CPRS legislation should be carefully drafted to discourage rent seeking behaviour by generators over the long term.

CPRS Fuel Credits Bill

Reduction in fuel excise

Finally the IGCC would like to register its opposition to the reduction in the fuel excise to offset the impact of a carbon price. Offsetting the price impact on fuel will dampen the incentive to change fuel use patterns and accordingly reduce the overall efficiency of the CPRS.

In particular, the IGCC is opposed to insulating heavy road users from the CPRS. Compensating heavy vehicle road users directly disadvantages other less greenhouse intensive transport sectors such as rail freight.

IGCC believes that the impact on low-income families from increased fuel prices should be dealt with the same as for the impact from electricity price rises (i.e. through the household assistance package).

Should you require clarification of any points in this submission, please contact the IGCC Secretariat on 02 9255 0290.

Yours sincerely,

Frank Pegan
Chair
Investor Group on Climate Change Australia/New Zealand