Hydro Tasmania
The power of natural thinking

19 February 2016

Submissions
Climate Change Authority
GPO Box 1944
Melbourne VIC 3001

By email: submissions@climatechangeauthority.gov.au

Dear Sir/Madam,

Re: Draft Report on Australia's Climate Policy Options

Thank you for the opportunity to provide comment on the Climate Change Authority's Special Review, Second Draft Report: *Australia's Climate Policy Options*. Hydro Tasmania has made submissions to previous CCA consultations including the Caps and Targets Review, the 2012 and 2014 RET Reviews and the Review of Australia's Future Emissions Goals.

Hydro Tasmania is the largest clean energy producer in Australia, and is internationally recognised for its expertise in renewable energy operation and development. As an integrated energy business and a material participant in the National Electricity Market (NEM), Hydro Tasmania is directly affected by national emissions reduction policies.

All major political parties support the goal of keeping global temperature rises to no more than 2 degrees. In addition, both the Federal Government and Opposition share a bipartisan commitment to an emissions target of 5% below 2000 levels by 2020 and to deeper emissions cuts by 2030. The agreement reached in Paris at the 21st Conference of the Parties to the UNFCCC provides a strong background for Australia's emissions commitments. The Intended Nationally Determined Contributions (INDCs) set in Paris should provide reassurance that major emitters including Australia's major trade partners will take comparable action to reduce their domestic emissions.

Australian Context

Recent domestic emissions projections[1] from the Department of the Environment indicate that Australia should meet its 2020 emissions reduction target under the current suite of policies including the Emissions Reduction Fund (ERF) and the Renewable Energy Target (RET). The emissions data also suggests that Australia's emissions are likely to increase in the short-term to

[1] https://www.environment.gov.au/climate-change/publications/tracking-to-2020

4 Elizabeth Street Hobart TAS 7000 Australia • GPO Box 355 Hobart TAS 7001 Australia
t 1300 360 441 f +61 3 6230 5363 e contactus@hydro.com.au w www.hydro.com.au
Hydro-Electric Corporation ABN 48 072 377 158

2020 and that therefore, further changes will be needed to meet the Government's 26% to 28% 2030 emissions reduction goal. Within this, the electricity generation sector currently accounts for around one third of annual emissions and is one of the sectors in which emissions are set to increase. This reinforces the central role that decarbonisation of the electricity sector will need to play if Australia is to reduce domestic emissions in line with international commitments.

The signing of the Paris agreement alongside confidence that Australia will meet its 2020 emissions target can allow this review to consider appropriate longer-term policies. As the paper sets out, it is important that policy options are assessed against a set of overarching principles. These principles need to take into account the effectiveness, distributional impacts and costs of policy approaches. While much of this work has previously been done from a theoretical perspective the review should also look to international examples and the practical experience of policies.

Specific questions from the paper are addressed as Attachment 1.

We would welcome the opportunity to provide the Climate Change Authority with further information about the contents of this submission or any other issues. Should you have any queries or require further information, please contact Colin Wain, Policy Development Manager (email: colin.wain@hydro.com.au or telephone: 03 8612 6443).

Yours faithfully

Colin Wain
Policy Development Manager
Hydro Tasmania

Attachment 1 – Australia's Climate Policy Options: Questions

Questions

Q.1. The Authority proposes assessing policies primarily on their cost effectiveness, environmental effectiveness and equity. Are these principles appropriate? Are there any other principles that should be applied, and if so, why?

The Authority's principles are appropriate and propose a suitable order for assessment of policies. Any policy approach that drives change within the economy will have costs and distributional impacts nonetheless, and in recognition of this, it is appropriate to look for the policy with the lowest net costs while also providing options to address the impacts across business and household sectors.

The effectiveness of a policy should be measured by its ability to reduce emissions in the medium to long-term and on the basis of whether the policy is capable of achieving the scale of emission reductions indicated by climate science.

Questions

Q.2. What lessons can be learned from Australia and overseas on the effectiveness of mandatory carbon pricing, and its interaction with other climate policies?

Q.3. How does mandatory carbon pricing perform against the principles of cost effectiveness, environmental effectiveness and equity? Which type of pricing scheme is likely to be more effective, and why?

Hydro Tasmania believes that a broad based carbon pricing signal can be an effective policy approach and has the potential to achieve deep cuts in domestic emissions. Inevitably, any policy will have costs and distributional impacts. Carbon pricing creates arguably the most obvious form of impact as (depending on the design) it will directly raise the cost of producing some emissions intensive goods and services. At the same time, mandatory carbon pricing is one of the suite of policies that can also generate revenue. This revenue can be used to address the impacts on business and household sectors.

Hydro Tasmania's long-standing position has been that carbon pricing can be an appropriate mechanism to lower Australia's emissions, particularly in the energy sector. The effectiveness of mandatory carbon pricing policy approaches can be enhanced if it is supported by complementary policy mechanisms that facilitate low carbon transformation in specific sectors – for example a renewable energy target and measures to retire aging coal fired power stations.

Any mandatory pricing scheme design should incorporate flexibility to accommodate changes in emissions reduction trajectories, the needs of emissions-intensive trade-exposed sectors and should facilitate long term investment certainty.

Questions

Q.4. What lessons can be learned from Australia and overseas on the effectiveness of voluntary carbon pricing, and its interaction with other climate policies?

Q.5. How does voluntary carbon pricing perform against the principles of cost effectiveness, environmental effectiveness and equity?

The effectiveness of voluntary carbon pricing may itself be a product of consumer sentiment towards emissions reductions. Experience in Australia suggests that the public awareness of, and appetite for action to lower emissions has shifted at several points over the last decade. At a high level, public support for voluntary action appears to have been higher in the absence of national action to lower emissions. One example of this is the GreenPower program which has seen customer numbers fluctuate with changing public opinions and Government policies.

In addition, it is worth considering that voluntary action will have different distributional impacts from mandatory pricing or other policy options. Given the substantial challenge of lowering Australia's emissions, unless there are significant shifts in public sentiment, it is unlikely that voluntary carbon pricing would be capable of driving the achievement of national emissions targets.

Questions

Q.6. What lessons can be learned from Australia and overseas on the effectiveness of renewable energy targets and energy efficiency targets, and their interaction with other climate policies?

Q.7. How do renewable energy targets and energy efficiency targets perform against the principles of cost effectiveness, environmental effectiveness and equity?

Australia's national renewable energy target has to date been highly successful in increasing the generation of electricity from renewable sources. This is in spite of considerable policy uncertainty as well as significant external factors such as the global financial crisis, exchange rate fluctuations and changes in federal and state environmental and planning policies. As noted in the 2013 Administrative Report of the Clean Energy Regulator, the Large-scale Renewable Energy Target (LRET) saw a compliance rate of 99.98% against 2013 liabilities.

Renewable Energy Targets can work effectively alongside emissions reduction policies. Hydro Tasmania strongly believes that the RET is complementary to the Government's Direct Action Policy. The RET is currently the only policy capable of making substantial reductions in the emissions intensity of grid-supplied electricity.

Renewable targets typically have multiple goals including industry development. In themselves, they do not replace the need for a national emissions reduction framework. With particular reference to Australia, one of the challenges of the current RET is that it is not designed to drive

the exit of ageing emissions-intensive plant. Without a policy or price signal that can trigger the closure of historic emitters, achievement of long-term emissions targets will be difficult.

Questions

Q.8. What lessons can be learned from Australia and overseas on the effectiveness of regulation, and its interaction with other climate policies?

Q.9. How could various types of regulation perform against the principles of cost effectiveness, environmental effectiveness and equity?

Regulation has the potential to be an effective emissions reduction tool. This is particularly true where the central emissions reduction policy does not cover all sectors or cannot provide the long-term price signals to drive transition.

Regulation is unlikely to be cost free if its intention is to drive change. However, where regulation can send a clearer price signal, provide greater certainty or improve competition for new investment, then regulation may complement, or even be a replacement for, some emissions reduction policies. It is also possible that where regulation can complement a carbon pricing mechanism, the required carbon price might be lower than it would be in the absence of regulation.

Questions

Q.10. What lessons can be learned from Australia and overseas on the effectiveness of information programs and innovation support, and their interaction with other climate policies?

Q.11. How do information programs and innovation support perform against the principles of cost effectiveness, environmental effectiveness and equity?

Questions

Q.12. What policies do you consider are best suited to which sectors and why?

Q.13. Are there sectors that are better suited to voluntary pricing in the short term and mandatory policies in the longer term and why?

It is clear that if the economy as a whole is to achieve considerably lower emissions, then the electricity sector will be a central part of this. The stationary energy sector is the single largest contributor to national emissions. Australia's future emissions reduction framework must provide appropriate investment and divestment signals for the energy sector. Ultimately reductions in domestic emissions will necessitate a transition to low and zero emissions generation.

Australian electricity generation is highly emissions intensive by world standards. At the same time electricity is fundamental to every facet of a modern economy. Australia must reduce the emissions intensity of its electricity generation if it is to meet future long-term emissions reduction.

The Safeguard Rule under the ERF set an electricity sector baseline of 198MtCO2-e. This does not indicate that emissions from the sector will definitely increase to this level however, it does permit this level of emissions without any penalty. The latest national emissions projections from the Department of the Environment also indicate that emissions from the electricity sector are expected to increase over the short-term. While demand and emissions projections in the sector have a high degree of uncertainty, increases in emissions, are not in the national interest. Such an increase in sectoral emissions could compromise Australia's ability to meet its 2030 and subsequent emissions targets.

The RET has been an effective mechanism which has increased the generation of electricity from renewable sources. While the RET has provided investment signals it is clear that there must also be a mechanism which promotes divestment and therefore closure of highly emitting plant over time.

Questions

Q.14. Which international competitiveness impacts are most important to designing Australia's climate policy toolkit, and why?

Q.15. What is the current risk of carbon leakage, in light of the Paris climate conference and associated national commitments?

Arguably, one of the most fraught areas of climate policy is how to treat emissions intensive trade exposed businesses. The closure of emissions-intensive or energy-intensive Australian businesses would quickly meet domestic emissions targets, but with high economic cost and may simply transfer the resultant emissions elsewhere. From a climate change perspective, given the wide range of low and zero emissions technologies available in Australia, there is no reason why Australia should not have a strong trade-exposed, energy-intensive sector in a low carbon global economy.

There is no easy solution to transitioning trade exposed sectors. They will need incentives to reduce emissions, will need to continue to modernise and employ best-practice technology as well as operating as efficiently as possible. Any national emissions reduction policy should seek to avoid disadvantaging trade exposed sectors but will also need to retain incentives to decrease emissions. A further necessary element will be a form of 'safeguard mechanism' (as under ERF) or similar approach that can ensure that any increase of emissions above normal operating levels comes at a cost or at a minimum is offset by decreased emissions elsewhere.

Relevant to any trade exposed discussion is the role of international permits. While most business groups and commentators support their inclusion, policy makers must consider that international permits may be only a short-term solution and cannot necessarily be relied upon as a long term strategy as both the volume available and the price is unknown in the future.

The recent Paris Climate Agreement should provide some comfort that key economies including Australia's major trade partners are taking action to reduce emissions. The Australian Government should continue to work with the international community to ensure an equitable outcome for trade exposed industries.

Questions

Q.16. Which sectors are most likely to face adverse impacts on their international competitiveness from climate policy and why?

Q.17. How do you think these impacts should be addressed?

There has been considerable commentary in the recent past about whether Australia's abatement approach was out of step with global action and therefore potentially harming economic competitiveness. The consequence of this discussion has been to assume that Australia will suffer if ambitious national emissions reduction targets are set. However, this would only be the case if key economies fail to take action to reduce their emissions. Arguably, the international competitiveness of Australian business is best protected through a strong international agreement that includes our major trading partners.

As shown in the August 2015 modelling for the Federal Government[2], in the context of global efforts, Australia's economy can be expected to continue to grow strongly under a range of emissions reduction targets.

Concluding remarks

Hydro Tasmania strongly supports a long-term policy framework that can drive emissions reductions over time and provide certainty to investors in low and zero emissions generation. The electricity generation sector represents one third of Australian's annual emissions and will be critical if longer-term emissions targets are to be met.

[2] *2015 ECONOMIC MODELLING OF AUSTRALIAN ACTION UNDER A NEW GLOBAL CLIMATE CHANGE AGREEMENT, McKibben*