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# LEARNINGS

## 10 YEARS OF CARBON POLICY

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## 1. Introduction

The link between economic prosperity and activities that generate greenhouse gases dictates that improved environmental outcomes must be achieved at the lowest possible cost to the community. To do otherwise will harm social conditions, particularly in economies that are more vulnerable to the impacts of climate change.

Policies that encourage long-term investment by industry in least-cost abatement will be critical to achieving meaningful reductions in emissions. A commitment by industry to making such long-term investment requires a stable and certain policy environment. This is not an environment that has been the norm in Australia as, over the past decade, climate change policy has been “...a polarising and highly political issue”<sup>1</sup>. As the Australian Climate Roundtable noted, “Delayed, unpredictable and piecemeal action will increase the costs and challenge of achieving the goal [of restricting temperature increases to less than 2°C]”<sup>2</sup>. This is demonstrated by the fall in investment in renewable energy generation during the recent debate over the Renewable Energy Target.

This document briefly canvasses the climate change policy environment that has applied over the past decade, lessons learnt, and the appropriate policy approaches required for sustainable investment in reducing emissions. It highlights that climate change policy should seek to achieve the following objectives:

- Provide policy predictability and stability.
- Strive for a long-term in approach.
- Be developed in a consultative manner.

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<sup>1</sup> *Australian Climate Change Policy: A Chronology*, Parliamentary Library, 2 December 2013, p.1.

<sup>2</sup> Press Release: *Broad Alliance Points to Common Ground on Climate Policy*, Australian Climate Roundtable, 29 June 2015.

## 2. Background

Australia's economy is built on a range of industries that have invested, or are investing, here due to Australia's historically competitive position in energy and resources. Accordingly, the Australian economy is comparatively emissions-intensive and, with ongoing investment in resource sectors such as natural gas, is likely to remain so.

Australia's emissions in 2011 were around 1.3% of the estimated global total (including land use and forestry) and are declining as a percentage of global emissions, while total emissions from developing economies increase significantly.

Policies directed at reducing greenhouse gas emissions are of critical importance to the competitive positioning of Australian-based industries and firms.

Over the past two decades, Australia has become significantly less emissions-intensive, partly reflecting an increased investment in energy efficiency in response to the increase in electricity costs in the period 2008 to 2013. However, it should be noted that some of this achievement is based on a fall in economic activity, particularly in the manufacturing sector, which is obviously not a desired outcome and contrary to the Government's intent of economic growth and increased investment.

Climateworks noted recently: "Since 1990, the overall emissions intensity of Australia's economy has almost halved and emissions per capita have decreased by approximately 25% over this period (ABS 2012, 2013a; DOE 2014)"<sup>3</sup>. As the Climate Change Authority commented, this is attributable "...to structural changes, new technologies, fuel switching and improvements in energy efficiency"<sup>4</sup>.

Trading Nations Consulting commented: "Australia has performed better than most other developed economies in constraining emissions growth since 1990. Its modest increase in total emissions of 2.4% from 1990 to 2012 compares favourably with Canada (+4.2%), Japan (+8.6%) and the United States (+2.7%) (p 6)...Taking into account emissions embodied in trade casts a still more positive light on Australia's emissions performance. If full account were to be made of the emissions embodied in trade by reporting consumption rather than production of emissions, the gap between Australia's level of reported emissions relative to the EU [European Union], the United States and Japan would narrow markedly"<sup>5</sup>.

Australia's carbon productivity has improved considerably. The PricewaterhouseCoopers' *Low Carbon Economy Index 2014* highlighted that over the period 2008 to 2013, Australia reduced emission intensity by 4.6%, whilst on average, GDP grew by 2.6% pa.

Australia is on track to meet its target under the second commitment period of the Kyoto Protocol.

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<sup>3</sup> *Pathways to Deep Decarbonisation*, Climateworks, 2015.

<sup>4</sup> *Final Report on Australia's Future Emissions Reduction Targets*, Climate Change Authority, 2 July 2015.

<sup>5</sup> *Climate Policy and Australia's Resource Trade*, Trading Nation Consulting, March 2015.

### 3. Climate Change Policy in Australia

Climate change has been on the policy radar in Australia and internationally for well over 20 years, as can be seen from chronology<sup>6</sup> provided by the Parliamentary Library of international and (federal) Australian developments in examining, making, modifying and abolishing, policy. “Australia has had over 200 pieces of legislation and policy response to the commitments (Kyoto Protocol) made in 1997”<sup>7</sup>.

Since the National Emissions Trading Taskforce reported its findings in 2006, every major review into climate policy has recommended an emissions trading scheme (ETS) policy approach to address emissions in the most efficient way. With the *Clean Energy Act* passed by Parliament under the former Labor Government in November 2011, Australia had a price on carbon for a short time, until a repeal of most aspects of the Clean Energy Future package saw the carbon price abolished on 30 June 2014 by the Coalition Government.

The Government has begun a phased introduction of its Direct Action policy, including an Emissions Reduction Fund (ERF), comprising two elements: (i) the fund, where contracts can be secured in a reverse auction or tender for approved emissions reduction activities, and (ii) a safeguard mechanism covering about half of Australia’s emissions, with the stated objective of “...[encouraging] businesses not to increase emissions above historical levels...”<sup>8</sup>. At the same time, the Government has highlighted that the ERF package is designed “...to allow businesses to continue ordinary operations without penalty. It is also founded on the presumption of economic growth as a positive and inevitable good for Australia”<sup>9</sup>. Legislation to establish the ERF was passed on 31 October 2014, and regulatory changes to the *National Greenhouse and Energy Reporting System* (NGERS) to give effect to the safeguard mechanism are currently before Parliament; the mechanism is expected to commence on 1 July 2016.

Alongside these policies, the Renewable Energy Target (RET) Scheme (an expansion on the 2001 Mandatory Renewable Energy Target) came into force on 1 January 2010, and was split into large-scale and small-scale components on 1 January 2011. After a review that commenced in April 2014, the RET faced an uncertain future while the Government and Opposition negotiated on amendments. An agreement was finally struck in May 2015 and received royal assent in June 2015.

Participation in the development and implementation of climate change policy has not been restricted to the Commonwealth; State and Territory Governments have introduced their own state policies and, prior to the commencement of the carbon pricing mechanism, the States stepped into the policy vacuum at the time and populated it with a proliferation of programs and regulations.

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<sup>6</sup> Research Paper: *Australian Climate Change Policy: A Chronology*, Parliamentary Library, 2 December 2013 ([http://www.aph.gov.au/About\\_Parliament/Parliamentary\\_Departments/Parliamentary\\_Library/pubs/rp/rp1314/ClimateChangeTimeline](http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/rp1314/ClimateChangeTimeline))

<sup>7</sup> *The Road to Paris: Post 2020 Climate Change Goals*, Australia-Israel Chamber of Commerce, Grant King (CEO Origin Energy), 24 June 2015.

<sup>8</sup> *The Emissions Reduction Fund: The Safeguard Mechanism*, Australian Government, 2015 (<http://www.environment.gov.au/climate-change/emissions-reduction-fund/publications/factsheet-erf-safeguard-mechanism>)

<sup>9</sup> *Emissions Reduction Fund Green Paper*, Australian Government, 2013, p.35 ([http://www.environment.gov.au/system/files/resources/66237232-3042-4cd8-99a3-040705fead3b/files/erf-green-paper\\_1.pdf](http://www.environment.gov.au/system/files/resources/66237232-3042-4cd8-99a3-040705fead3b/files/erf-green-paper_1.pdf))

On 31 July 2008, Mr Roger Wilkins AO handed the Government his *Strategic Review of Australian Government Climate Change Programs* (the Wilkins Review)<sup>10</sup>, which examined the climate change policy landscape across all levels of Government, developed a set of complementary principles (in the context of a comprehensive ETS), and assessed whether climate change programs were efficient, effective, appropriate and complementary to the Carbon Pollution Reduction Scheme, which was the proposed federal climate change policy at the time.

Despite the obvious changes in the overall climate policy approach since this time, the complementarity principles remain relevant where a national-level policy is in place (or in development) to meet an emissions reduction target. The Wilkins Review found more than 200 policies and programs around Australia addressing climate change, which would interfere with the smooth operation of a national approach<sup>11</sup>.

Shortly after the Wilkins Review was published, this large volume of policies began to slowly reduce. With the introduction of the expanded RET and the carbon pricing mechanism, some schemes were shelved in development or repealed (e.g. the Victorian Energy Efficiency Target, the NSW Greenhouse Gas Abatement Scheme). Much work remained to be done, but a promising beginning had been made to the streamlining task.

A number of State Governments are now reconsidering jurisdictional climate policy and it appears that any positive momentum the Wilkins Review generated to reduce the number of competing climate policies, may have been lost.

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<sup>10</sup> *Strategic Review of Australian Government Climate Change Programs*, Roger Wilkins, 31 July 2008 (<http://www.finance.gov.au/sites/default/files/Climate-Report.pdf>)

<sup>11</sup> *Ibid.*, p.2.

## 4. Important Lessons

### ■ A Bipartisan approach is the only sound basis for policy stability

As the political landscape currently stands, entities operating in Australia face renewed uncertainty at each federal election owing to the differing policy approaches by the major parties to addressing climate change. The two major parties support the goal of limiting global warming to less than 2°C. Both went to the 2007 election with a policy platform including an ETS, but since 2010, approaches have diverged. As it stands, in 2013 the Coalition formed Government and repealed the carbon pricing mechanism, whilst the Labor Opposition promises to repeal the Direct Action policy if it forms Government after the 2016 election, and to re-introduce an ETS.

The absence of institutional stability reduces the competitiveness of Australian operations, as investment dollars flow to destinations offering more stability in the operating environment. A stable, long-term policy framework that prices carbon in a predictable manner and offers appropriate support to ensure international competitiveness is essential for economic growth and prosperity. Such a policy is ‘bankable’ in that it provides the certainty that supports investment.

### ■ Long-term stability requires a common goal

When the Rudd Government was developing the Carbon Pollution Reduction Scheme in 2008, the work was undertaken under a number of policy principles and headline emissions reduction targets (unilateral -5% of 2000 emissions by 2020, with conditional -15% and -25% targets depending on actions of other countries, and -80% of 2000 levels by 2050). The Coalition (in Opposition) supported these targets.

With the accumulated developments since this time, bipartisan agreement on these goals has been lost. The only enduring target is the -5% goal to 2020. What happens outside of this timeframe is now much more vague.

Recently, the Coalition Government announced a target range of 26% to 28% from 2005 levels by 2030, as part of the package it is taking to the international negotiations in Paris. The Opposition has not explicitly rejected this target, but its apathy towards the target is also not helpful to industry. Without bipartisan support for the target, another opportunity for providing some measure of stability will be lost.

### ■ Efficient and cost-effective mitigation necessitates a strong national policy, and a strong reduction of state-based programs

If and when the costs of goods and services, globally, reflect a price for emitting greenhouse gases, it has the capacity to bring about a major shift in the way consumers make purchasing decisions, and possibly change the comparative advantage paradigm in several sectors. The first step toward achieving unified and effective global action, is to demonstrate unified and effective domestic action.

The abundance of state-based climate policies does nothing to help Australia play its part in reaching this goal. By layering policies over one another, there will be multiple costs on some emissions-related activities (and possibly no costs in other areas). By forcing entities to comply with a patchwork of different policies in different jurisdictions, compliance costs are driven up; this wastes resources that, with intelligent policy, could be directed into actually reducing emissions. Higher compliance costs translate to higher costs of production, and greater difficulty in securing investment.

The only rational response to this situation is to drastically reduce state-based climate policies and programs. The role of State and Territory Governments in addressing climate change is to support a

national approach, to enable a simple, consistent and long-term national policy to properly reduce emissions, and achieve national emissions reduction targets. Involvement should be limited to instances of genuine market failure, where there is strong evidence that a national approach is not working or has not been attempted.

- **Policy should be, as far as possible, based on market measures and only apply where evidence of market failure exists**

One of AIGN's key policy principles is support for a market mechanism in reducing emissions, as market forces are the most efficient in determining where the lowest cost abatement can be sourced. In most circumstances, market forces lead to the most efficient use of resources and, in principle, Australian companies should operate with minimal regulatory intervention related to energy.

As an example, energy efficiency is an area of considerable policy intervention, with programs such as the recently abolished Energy Efficiency Opportunities Program. This program, which required large energy users to report annually on internal activities investigating opportunities to improve energy efficiency, was introduced with no evidence that large energy producers and users did not have appropriate internal metrics for making investment decisions.

AIGN considers that the current mix of measures and market signals is demonstrably sufficient for companies to make informed investment decisions with respect to energy. Investment in energy efficiency is fundamentally a business decision, which is impacted by a wide range of considerations. Energy using and producing entities have complex internal decision-making processes, enabling them to weigh a wide range of factors; energy investment decisions are driven by the combined costs of all inputs and best reflect a company's perspective of the economic environment and their competitiveness within it.

AIGN notes the ongoing development of a National Energy Productivity Plan, potentially in conjunction with State Governments, which may target a number of different sectors such as commercial buildings and the residential sector. It could potentially build on existing successful consumer-focussed programs such as improving the energy efficiency of lighting and domestic appliances. AIGN considers that Governments can best support investment in industrial business efficiency by providing a stable, nationally integrated, industrial energy and climate change policy environment in which policy risks are minimised.

- **Trade competitiveness should not be influenced by carbon policy until it becomes commonplace in the global market.**

In an ideal world where a uniform emissions price is globally applied, administrative assistance for entities competing to supply goods on international markets, and who are unable to pass on these costs, would not be required. However, we are not yet in that ideal world.

The need to provide assistance to trade-exposed industry has been recognised in every major review of emissions pricing in Australia. It was a key part of the ALP's election platform in 2007, where the party promised no trade-exposed industry would be disadvantaged. The Jobs and Competitiveness Program provided a system where trade-exposed firms would not be exposed to the full price signal, but fell short of the level of assistance required by some trade-exposed industries. It is an essential component of international schemes such as the European Union Emission Trading Scheme.

Dependent on the nature of any future climate change policy, the level of assistance to trade-exposed industry should be determined by the level of trade exposure across the scope of operations, with



reference to each cost on emissions being placed on the international competitors of individual industries. Definitions of ‘activities’, if used, should reflect the full suite of industrial processes that give rise to the production of a good that is traded. Any decay in the rate of assistance must be linked to the extent that a carbon price signal is present in the global market of each industrial sector.

- **The climate policy package must have comprehensive coverage of the Australian economy to ensure an equal contribution from all sectors.**

An effective response to the challenge of climate change should aim to deliver abatement at the lowest cost, be it through domestic abatement activity or through access to international opportunities. To achieve that objective, it is vital that coverage (under whatever policy instrument/s may apply) is comprehensive across the economy, covering all greenhouse gases, all sources and all sinks, so that the burden of emissions reductions is borne equitably across the economy.

For example, the Clean Energy Future package covered about 59% of Australia’s emissions, but the default caps meant that around 80% of the burden of Australia’s 2020 commitment would need to be met by the scheme participants. This was clearly an unfair burden.

Under the safeguard mechanism, the proposed emissions baseline threshold of 100,000 tonnes for inclusion within the scheme will limit coverage to only those entities responsible for 50% of Australia’s emissions. Coverage could be even less if a separate sectoral arrangement is developed for the electricity industry and dependent on its nature.

Under either of these scenarios, coverage would be limited and the burden of emissions would not be borne equitably across the economy. Equitable coverage would require that the emissions reduction target applied to the ERF and safeguard mechanism were commensurate with the level of coverage, and the remaining target addressed by other policy tools applying to the uncovered sectors.

- **Reporting arrangements must not result in a disproportionate cost burden on covered entities.**

Compliance costs and regulatory burdens should be minimised. Confidentiality of company information was critical in gaining industry support for the provision of commercially sensitive data in the original establishment of the National Greenhouse and Energy Reporting Scheme (NGERS), and remains valid to this day. For those entities covered by any policy instrument, the only information published should relate to aggregate baseline and emissions information. Anything more than this would be a breach of the good faith in which entities agreed to provide the Government with this data.

Regular public and independent reviews should be conducted of Australia’s climate change policies.

- **Least-cost abatement should continue to be a priority.**

Consistent with the AIGN principle of least-cost abatement, emission reduction policies should provide access to international units, including the Clean Development Mechanism. AIGN supports the Climate Change Authority’s past comments that allowing access to international abatement opportunities reduces the risks associated with achieving a stated abatement task compared to achieving this task through domestic abatement alone.

AIGN considers this will promote genuine emissions reductions, assist with maintaining Australia’s international competitiveness, and address the potential for leakage. Furthermore, it will have the additional benefit of establishing a more liquid market, with long-term hedging options.



## Attachment 1. AIGN Policy Principles

AIGN's position on climate change is informed by the following principles:

Australia should make an equitable contribution, in accordance with its differentiated responsibilities and respective capability<sup>12</sup>, to global action to reduce greenhouse gas emissions and to adapt to impacts of climate change. Policy approaches should be based, as far as is practicable, on market measures with the objective of least-cost abatement.

Australia should engage the international community in pursuing identified and beneficial environmental outcomes through greenhouse gas emissions reduction action that:

- allow for differentiated national approaches;
- promote international cooperation;
- minimise the costs and distributes the burden equitably across the international community;
- is comprehensive in its coverage of countries, greenhouse gases, sources and sinks;
- recognises the economic circumstances, social circumstances and aspirations of all societies; and
- is underpinned by streamlined, efficient and effective administrative, reporting and compliance arrangements.

In this global context, Australia should develop a strategic national approach to responding to climate change that:

- is consistent with the principles of sustainable development;
- is consistent with other national policies, including economic growth, population growth, international trade, energy supply and demand, and environmental and social responsibility;
- takes a long-term perspective;
- maintains the competitiveness of Australian export- and import-competing industries;
- distributes the cost burden equitably across the community;
- adopts a consultative approach to the development of new policies; and
- is consistent and effectively co-ordinated across all jurisdictions throughout Australia.

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<sup>12</sup> Australia's contribution to the global climate change effort as set out here reflects the principle in Article 3.1 of the United Nations Framework Convention on Climate Change. Differentiated responsibilities and respective capabilities could take account of such matters as a country's economic growth and structure, population growth, energy production and use etc.



Australia's future greenhouse policy measures should:

- be consistent with the strategic national approach;
- be trade- and investment-neutral, in a way that does not expose Australian industry to costs its competitors do not face;
- not discriminate against new entrants to Australian industry nor disadvantage early movers in Australian industry who have previously implemented greenhouse gas abatement measures;
- take account of differing sectoral circumstances;
- be based as far as is practicable on market measures;
- balance, in a cost-effective way, abatement and adaptation strategies, both of which should be based on sound science and risk management;
- address all greenhouse gases; and
- address all emission sources and sinks.