



IPART Review of NSW climate change mitigation measures

A response by the Australian Industry Group, February 2009

Overview

The Australian Industry Group welcomes the Review of NSW climate change mitigation measures being undertaken by the Independent Pricing and Regulatory Tribunal (IPART). Ai Group, and its member companies, considers the issue of climate change, with the resulting environmental, commercial and regulatory implications, as a primary area for public policy focus. We also view the interplay between national policies, such as the Federal Government's flagship Carbon Pollution Reduction Scheme (CPRS), and State based initiatives as a crucial factor in determining the future costs, economic impact and likely success, of Australia's climate change measures.

Ai Group believes that regulatory framework for all climate change mitigation policies must be enshrined in better regulation principles. The United Kingdom's Better Regulation Taskforce summarises these as:

- Proportionate: regulatory intervention should occur only where necessary;
- Accountable: regulators must be able to justify decisions and be subject to public scrutiny;
- Consistent: regulation should be 'joined-up' and implemented fairly;
- Transparent: regulations should be simple and user-friendly;
- Targeted: regulations should be focused on specific problems and minimize 'side effects'.

As evidenced in Ai Group's submissions to the Federal Government's consultation process on the CPRS, we also believe that the following fundamentals should apply, irrespective of whether the policy instrument is designed for national or State-based implementation. Climate change measures should:

- Maximise transparency and minimise costs;
- Rationalise existing environmental regulations and targets;
- Focus on areas where there is a clear risk of market failure;
- Help deliver least cost abatement;
- Assist the effective functioning of a carbon market;
- Avoid artificial, market distorting measures;
- Be subject to periodic assessment and review.

At present, Ai Group believes that an array of policy instruments, incentives and targets are causing confusion and adding cost for business. In particular, the historic pattern of Federal, State and Territory legislators effectively competing against one another to implement environmental regulation is both unhelpful and highly inefficient.

Furthermore, Ai Group believes that IPART should consider the model of a regulatory 'budget' for climate change measures. This would rationalise existing environmental targets and regulations, and accurately reflect the economic costs and benefits attributed to schemes designed to combat climate change. Such a process will, we believe, help meet the stated desire of least cost abatement, whilst assisting business by providing greater regulatory efficiency and transparency.

Regulatory and Market Efficiency

The existing approach to regulatory intervention on climate change is essentially 'ad hoc' and it is in the interest of both the NSW Government and industry for climate change measures to be implemented in a more strategic and efficient manner.

A revised regulatory model, one that focuses relentlessly on least cost abatement and which harmonises complementary policies whilst removing policies that are not complementary, should be both easier to administer and more effective in addressing climate change.



At all times it is crucial to remember that, as a market based solution, CPRS requires a freely functioning market in order to operate effectively. Consequently, schemes operating outside of the CPRS, including those with good intentions, risk artificially distorting the market and inflating the price of carbon unless they are very carefully thought through, and even more assiduously implemented.

In most areas, Ai Group believes, the CPRS negates the need for complementary programs by placing a 'true' price on the cost of carbon. Consequently, the market will naturally drive business investment and consumer behaviour towards those technologies that help reduce greenhouse gas emissions in the most cost effective manner. Conversely, a failure to rationalise programs risks compromising the effectiveness of both these related schemes and the CPRS itself.

Complementary programs, where required, should be confined to addressing areas where there is likely to be a natural absence of market incentives, i.e. incentives to drive research and development in low-emissions technologies, or where there is clear evidence of a market failure. Even then, such measures should only be undertaken if it is clear that the benefits will outweigh any potentially distortive effects on the functioning of the formal carbon market.

The Federal-State Conundrum

It is imperative that Australia's national climate change effort is not undercut by State programs. Ai Group endorses the views set out by the Productivity Commission, which stated:

"With an effective ETS, much of the current patchwork of climate change policies will become redundant and there will only be a residual role for state, territory and local government initiatives".

Ai Group strongly supports the established COAG Reform Council processes designed to tackle regulatory inefficiency and duplication, particularly in relation to the CPRS. In that context, we fully support the Review process being undertaken by IPART, and urge the NSW to embrace a deregulatory approach to any complementary measures. However, it is essential these processes deliver tangible results. Business is judged on tangible results and so should better regulation/de-regulation initiatives.

Whilst championing an essentially national approach to

climate change mitigation, this does not mean that Ai Group sees no role for the States and in climate change policy. In particular, we fully recognise that State governments are often best placed to play an important role in providing consumers and businesses with relevant information, promoting best practice and by driving implementation by public sector example.

If the NSW Government is to play its part in transitioning the State to a low-carbon economy at the lowest possible cost, it is essential that a least cost abatement test is applied to all current and future programs. A test of this nature would require climate change measures to ensure that abating each tonne of greenhouse gas emissions takes place at a cost that is no higher than the market-established carbon price. Such an approach would be entirely consistent with the market based model of CPRS. It would also help build wider business confidence in complementary schemes whilst ensuring an accurate, undistorted carbon price.

Renewable Energy Targets

Ai Group fully supports the development of renewable technologies and endorses measures to help deliver energy efficiency - but not at the expense of an efficiently operating carbon market.

Energy efficiency measures, in particular, should be embedded into commercial practice as a common sense tool for reducing everyday business costs. A failure to do so, given the current volatility in global energy prices, is both reckless and unsustainable. Equally, renewable energy is, and should remain an essential part of Australia's energy mix, but its uptake should be driven by market forces not blunt policy instruments.

Ai Group does not support the Australian Government's proposed Renewable Energy Target (RET) for this reason and we certainly see no need for the NSW Government to continue with a separate, and potentially highly distortive, target for the uptake of renewable energy. Such a program is likely to result in abatement costs that are higher than necessary to meet Australia's emissions reduction targets. The effects of such distortions will adversely impact on both households and businesses throughout the State.

Procurement

Whilst recognising that public procurement also has responsibilities to minimize the production of greenhouse gases, Ai Group retains concerns about the inclusion



of specific climate change criteria in NSW procurement processes. Primarily, our reservations are based on the fact that the CPRS will directly impose cost and environmental obligations on those private sector partners bidding for State contracts. As such, climate change mitigation is already built in to the procurement system and there is no need for further prescription by State authorities. In addition, the fact that the CPRS will impose a cost on the production of greenhouse gases should ensure that businesses engaged in public sector work will naturally favour low cost abatement in any contract delivery.

IPART Review – Specific Comments

Scope

Ai Group notes that the scope of this Review has been set by the NSW Government, which has nominated 12 existing climate change measures for IPART to assess. These measures are consistent with wider arrangements agreed between New South Wales and COAG but from an industry perspective there are a range of additional policy and regulatory measures that should have also been considered as part of IPART's work.

In particular, Ai Group believes the scope of IPART's work should have been extended to allow for a thorough analysis of other, non-environmental, regulations which might adversely affect the operation of the carbon market introduced by the CPRS. An example of this is NSW's Electricity Tariff Equalisation Fund which constrains retail price adjustments when wholesale prices shift. Ai Group recognises that there is an intention to do away with this Fund in the future, nevertheless it demonstrates that other aspects of the NSW regulatory environment may impact upon the carbon market; and that a wider set of complementary measures needs to be examined and subjected to equally high thresholds, not just the overt climate change measures nominated by the NSW Government.

Assumptions

Ai Group strongly endorses the 4 main assumptions underpinning IPART's work. For the record, we see these as:

- The threshold for justifying additional measures should be high.
- The Review should assume that CPRS will be capable of

reducing emissions in the long term

- The objective of any additional measures should, in principle, be to lower the costs of achieving a reduction in greenhouse gas emissions
- Should there be design flaws in the CPRS that compromise its ability to reduce emissions efficiently; these would be better addressed by adjusting the CPRS' scheme rather than introducing additional measures.

As IPART's consultation paper itself notes "Under a well-functioning emissions trading scheme, additional measures to reduce emissions would lead to the displacement of abatement that would otherwise have occurred more efficiently under the scheme, and alter associated changes to economic activity. This could add to the costs of adjustment (reform to a low carbon economy) and increase the costs of achieving the emissions target"¹. Given this admission, Ai Group believes the 'burden of proof' for new measures must fall on Government, i.e. evidence must be produced to show how an additional measure can be brought forward without compromising least cost abatement, rather than an assumption that new measures can be applied with supporting evidence provided afterwards.

Inconsistencies

Ai Group agrees with IPART's identification of inconsistencies within the CPRS, particularly with regards to the fuel price offset. As Ai Group made clear in its response to the Federal Government's Green Paper on the CPRS [<http://www.aigroup.com.au/portal/site/aig/policy/submissions/>] we cannot see an economic or an environmental case for such a measure and will continue to advocate for its removal.

Assessment Criteria

IPART's consultation paper proposes a set of criteria to assess the need for additional/complementary measures. In response to these criteria, Ai Group would like to make the following comments:

Mitigation measures criterion 1a, uncovered sectors – Ai Group has serious doubts over the applicability of State governments introducing measures to target uncovered sectors. As CPRS is a national scheme, coverage issues should be addressed in due course by the Federal not State government.

Mitigation measures criterion 1b, market failure – Ai Group agrees that an area where additional measures may be appropriate is where a tangible market failure has



occurred. However, it should be noted that at this stage it is impossible to predict where such failures might occur. As a consequence, Ai Group is of the view that the CPRS should be allowed to operate essentially unencumbered by additional measures, and that such measures should only be subsequently implemented when it is apparent a market failure has occurred. It should also be pointed out that, as a market mechanism itself, the best way to ensure that the CPRS does not contribute to a market failure is to allow the carbon market to operate in as true and efficient manner as possible. Information failures and barriers to effective competition are two areas where some pre-emptive action may be required. Certainly, accurate information is essential if businesses are to make informed decisions on the implications of the CPRS for their operations; as such Ai Group believes the NSW Government has a valuable role to play in working with industry to ensure that any information gaps are filled. In relation to potential barriers to competition that might impact upon the efficient operation of a developing carbon market, Ai Group would see any precursory work as the responsibility of the Federal Government and relevant national competition authorities, albeit informed, where appropriate, by evidence submitted by State administrations.

Mitigation measures criterion 2, state or local intervention – As the consultation paper makes clear climate change is a global problem to which the Federal Government has initiated the CPPS as Australia's primary policy instrument. Consequently, Ai Group supports IPART's findings that the primary responsibility for taking action on least cost abatement rests 'at the federal rather than the state or territory level'². Furthermore, we support IPART's suggestion that a specific assessment framework should be developed to assess the suitability of any State based measures, with clear evidence required to justify why a non-Federal response is the optimal solution.

Non-mitigation measures criterion 1, assisting transition – Ai Group agrees that there are circumstances where government action maybe required to assist industry and the community transition to a low carbon economy. However, we also believe that the case for such interventions must be clearly made, based on evidence, and minimize any unintended consequences, such as distortions to the carbon market. In addition, in most instances, Ai Group believes that these interventions should be limited in both scope and duration, with a clear path for winding down such measures once a suitable transition period has elapsed.

Non-mitigation measures criterion 2, state or local intervention – As indicated above, Ai Group agrees with IPART's proposal that that a specific assessment framework should be developed to assess the suitability of any State based measures, with clear evidence required to justify why a non-Federal response is the optimal solution.

Measures with multiple objectives criterion 1, wider cost effective policy measures – Ai Group endorses the recommendation contained in the consultation paper that any such measures should be assessed against good policy and regulatory practices. As indicated above, Ai Group believes a series of better regulation principles should be applied in all aspects of climate change policy.

Final Framework

Ai Group supports many aspects of IPART's proposed approach, particularly the rigorous process outlined to determine both the suitability and efficiency of any State based climate change measures. In addition, Ai Group believes that there must be a clear onus on State administrations to prove clearly and unequivocally the need for complementary measures – the working assumption must be that CPRS and a fully functioning carbon market are the best instruments to drive the behavioural changes that will help Australia meet both its climate change and economic objectives.

NSW Climate Change measures

Ai Group's comments on NSW's existing climate change schemes are summarized briefly below:

Greenhouse Gas Reduction Scheme (GGAS) – The implementation of the CPRS renders this scheme redundant and Ai Group supports moves announced by the State Government to end GGAS when the CPRS starts in July 2010.

Climate Change Fund – For a transitional period Ai Group sees no reason why this fund could not continue as a supplementary measure working in parallel with the Federal Government's Climate Change Action Fund (CCAF). Over time, Ai Group believes it makes more sense for CCAF to retain the specific funds needed to assist businesses in each state move to a low carbon economy.

NSW Green Business Program – Again, providing the Program's administration can be delivered in a way which complements, rather than confuses, the implementation of CCAF measures then Ai Group sees no reason why it should not continue.



Public Facilities and Schools Energy Efficiency Programs

– For a transitional period Ai Group sees no reason why this fund could not continue as a supplementary measure working in parallel with the Federal Government’s Climate Change Action Fund (CCAF).

Renewable Energy Development Program – As with the National Renewable Energy Targets Scheme (NRETS), Ai Group believes that such a program may have a distortive effect by providing perverse incentives to invest in areas which are not focused on least cost abatement. Ai Group believes market signals provided by a realistic carbon price are the best drivers of least cost abatement and will, in time, provide the required stimulus for renewable energy technologies.

NSW Energy Efficiency Strategy – Ai Group believes that energy efficiency is an important part of NSW’s and Australia’s climate change response. However, it is questionable as to whether State administrations are best placed to deliver such strategies. Whilst not calling for the scrapping of this Strategy, at this stage, we believe serious consideration should be given to incorporating State energy efficiency programs in to wider national efforts.

NSW Energy Efficiency Trading Scheme (NEET) – Ai Group disagrees with the NSW Government’s belief that NEET is still required to overcome barriers to the take up of cost effective energy efficiency opportunities. In our view, such an assertion is highly questionable given the range of measures available at the national level.

Low Income Household Retrofit Program & Small Business Energy Efficiency Program – For a transitional period Ai Group sees no reason why these programs could not continue as a supplementary measure working in parallel with the Federal Government’s Climate Change Action Fund (CCAF). Over time, Ai Group believes it makes more sense for CCAF to retain these responsibilities.

Sustainability Advantage Program – Since its establishment in November 2006 Ai group has worked in conjunction with the NSW Government to help industry reduce waste, energy and water use. Although not principally a climate change measure, Ai Group believes the program’s success warrants its expansion, with serious consideration being given to a national roll-out.

Energy Efficiency Community Awareness Program & Energy Efficiency Skills Development Program – For a transitional period Ai Group sees no reason why these programs could not continue as a supplementary measure working in parallel with the CPRS. However, over

time, Ai Group suggests that the programs be adjusted and implemented to ensure they complement the CCAF information stream – as highlighted by COAG’s recent announcement on the CPRS

Building Sustainability Index (BSI) – As with other sustainability programs the BSI provides related climate change benefits but is not principally a climate change program. As such, and given the programs success to date, we see no reason for the BSI not to continue. In due course, Ai Group believes this initiative has the potential to be deployed at a national level.

Biofuel (Ethanol Content) Act 2007 – Questions remain over whether biofuels are the best environmental solution to transport produced greenhouse gas emissions. Given this ongoing uncertainty Ai Group believes that a dedicated biofuels measure is not required and that a well functioning carbon market is a more effective way of driving low cost abatement in transport.

Clean Coal Fund – Ai Group believes that the development of clean coal technology is clearly a national priority, and an area in which the Federal Government has already launched a number of substantial initiatives. In this context we recommend that the NSW’s Clean Coal Fund is rapidly rolled in to these national efforts. There appears very little justification for retaining a specific State-based scheme.

Gas & Electricity Licence Conditions – As evidenced in Ai Group’s submission to the Federal Government’s CPRS Green Paper, we believe that energy market reform and investment is key to Australia’s climate change efforts. However, the primary focus of such effort needs to be on ensuring there is an efficient and truly inter-connected energy grip operating upon the Eastern seaboard. Existing environmental criteria enshrined in gas and electricity license conditions should be removed in favour of measures that are consistent with CPRS and able to operate across the Eastern states.

Carbon Neutral NSW Government – Although a relatively modest scheme, Government leadership on climate change is important. In order for industry to have credibility in flagship schemes such as the CPRS it is crucial that the Federal and State government are seen to be ‘walking the walk’ and not just ‘talking the talk’.



Conclusion

Ai Group believes it is important the NSW Government seizes the opportunity presented by the introduction of the CPRS to reduce the regulatory burdens placed on industry but the current swathe of climate change measures. In particular, the Government should attack those measures which are likely, if left unchecked, to lead to higher than necessary abatement costs.

Ai Group believes that an efficient suite of measures are both in the public and business interest and will play an important role in building credibility in both the Federal, and NSW, Governments approach.

Ai Group reaffirms its view that a market based solution is the most effective way for NSW to contribute to national and international efforts to tackle climate change.

CPRS is, and should remain, the principal policy tool for all governments (State or Federal) to tackle climate change. As such, the aim of CPRS to reduce greenhouse gas emissions at the lowest cost to the economy is an approach which should be adopted by the NSW Government. By imposing a strict least cost abatement test, Ai Group believes the NSW Government will be best placed to achieve its all stated climate change policy objectives.