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Carbon Abatement Expert Panel

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REVIEW OF OPPORTUNITIES FOR FURTHER ABATEMENT

The Australian Industry Group (Ai Group) welcomes the chance to provide short preliminary input on the questions raised by the Expert Panel's discussion paper on opportunities for further abatement. The short timeframe for response has precluded detailed feedback from our members, and therefore this input should be taken as indicative rather than representing a final view from industry. We encourage the Panel to consider the detailed input provided separately by Bluescope Steel. We have also collaborated with other stakeholders to provide letters on the discussion paper overall, and on energy efficiency in particular. This letter includes further input on other specific elements of the discussion paper.

General comments

Global efforts to combat climate change will ultimately require net emissions of greenhouse gasses to reach net zero or below in most countries, including Australia. This transition will take decades and entail substantial changes in technology and practices across many sectors. It cannot be achieved solely through activity in the land and electricity sectors, the two that have received the most policy focus so far.

Overall the formulation and implementation of Australian climate policy should take account of the [principles](#) elaborated by Ai Group and the other members of the Australian Climate Roundtable. Any climate policy will have costs, whether explicit or not. It is important that these costs are spread fairly and the most vulnerable are protected. The suite of policies adopted should pursue the ideal of least-cost abatement. Access to the full range of potential abatement is crucial to minimise costs: there are emissions reduction opportunities in every part of the economy, on both the supply and demand sides, and in both Australia and overseas. Holistic design and geographic neutrality are important, for instance in coverage of Australia's several electricity systems. Market mechanisms, including price signals and tradable instruments, can be very efficient and effective if well designed, though there are roles for careful regulation and public funding as well.

The existing landscape of policy and proposals is far from consistent with these principles. This is inspiring interventions by many Australian governments; uncoordinated action will have costs and complexities of its own. In this context we welcome fresh effort by the Commonwealth to enhance its policy approach. Refinements and additions to existing policy will need to be carefully developed and extensively consulted on. The current consultation process should be only the beginning of this. The development of a Long Term Strategy and consideration of the future of Australia's clean economy innovation framework are also critical processes and lie beyond the existing funding envelopes of the Climate Solutions Package (CSP) and Climate Solutions Fund (CSF).

Australian policy should also incorporate the opportunity for international trade in valid emissions units and offsets. The Government's in-principle decision to allow the use of international units still needs to be followed by a decision on the specific kinds allowable. This is complicated by the facts that while the Paris Agreement framework establishes principles for bilateral exchange and calls for a multilateral offset system, detailed rules for these have not been agreed and Australia does not appear to have progressed any bilateral discussions. Imports from and exports to international markets have the potential to moderate the costs of Australia's transition. Australia should continue

to argue for effective international rules; advance bilateral and plurilateral arrangements consistent with the Paris Agreement principles; and ensure that the overall climate policy suite makes efficient use of international markets.

The paper raises several options for seeking additional abatement, addressed in turn below.

Crediting below Safeguard Mechanism baselines

This is a potentially very important option that will require especially careful and consultative development. The changes to the Safeguard baselines that are currently being implemented are expected to result in baselines that are close to actual emissions, removing the overall headroom that previously existed, but do not penalise or drive change to existing emissions. In theory, establishing a simple methodology to credit facilities that outperform against these tighter baselines emissions could create an incentive for improvement while avoiding complex and off-putting additionality assessments.

However, there are many difficult issues involved.

The new baselines may not be sufficiently tight for outperformance to represent real improvement. This is particularly the case where baselines are derived from industry average emissions intensity; by definition there will be some participants below this level. Crediting them for this might encourage greater production from low-intensity producers, but many nonadditional credits would likely be issued for each unit of genuine abatement incentivised.

Trying to ensure greater additionality with further tests or scrutiny before crediting would increase the cost and complexity of participation, weakening the incentive to respond. Much of the point of crediting below baselines is to avoid the complexity that has diminished participation in the Emissions Reduction Fund (ERF).

The treatment of Scope 1 and Scope 2 emissions is a serious barrier to a simple crediting arrangement. For many Safeguard entities, electricity consumption is a major share of their total emissions and investing in efficiency or clean energy are important opportunities. Under the current Safeguard electricity-related emissions are the responsibility of the generator, and generators are subject to a sector-wide baseline that is far above current or expected future emissions. Without substantial changes to the treatment of Scope 2 emissions or electricity sector baselines, crediting below baselines has limited potential to address electricity efficiency and clean energy without additional scrutiny that would be comparable to existing unattractive ERF methodologies.

Major improvements in facility emissions are likely to require large upfront investments in new and upgraded equipment and structures with a substantial life. While energy efficiency or renewable energy generation would be expected to reduce long-term operating costs, some other abatement options will increase them: carbon capture and storage or the substitution of hydrogen for fossil fuels appear to have an inherent cost premium, though this should shrink with scale, learning and innovation. These upfront and ongoing costs for abatement make the duration, certainty and value of crediting critical to investment decisions. The more uncertainty around future issuance, demand and price, the harder it will be to underpin major investments. On the other hand, greater certainty for investors comes at the cost of reduced flexibility for government and, potentially, a higher risk of paying for non-additional abatement.

Approaches could include:

- Annual crediting against baselines with no government commitments. Credits would compete against other options for purchase at future prevailing prices. This would provide certainty to investors only to the extent that crediting arrangements were stable, and would otherwise be highly uncertain.
- Contracts committing government to purchase agreed volumes of credits from Safeguard entities at an agreed price over an agreed period, with payment on delivery.
- An open ended government commitment to purchase unlimited credits from safeguard entities at a prescribed price. If credibly sustained, this might provide the greatest confidence for widespread investment.

- Safeguard entities could exchange some portion of their future baselines for upfront credits – taking a permanent reduction in baseline and simultaneously generating the funds to underpin investments that would make that lower baseline achievable.

Any form of crediting below baselines would also necessarily involve taking a view, whether tacit or explicit, on future expectations for the emissions intensity of safeguard entities. Should any improvement below current intensity be creditable for the life of a facility? Is a certain rate of improvement expected? Should inherent deterioration of emissions intensity be expected (for example in resource extraction) or intensity cycles be accounted for (for example in furnaces)? Should crediting for overperformance against a baseline for a period have any effect on the baseline for subsequent periods? If the Government considers upfront crediting to underpin major investments, it will also need to estimate the future life of a facility.

Crediting annually on an intensity basis could reduce the need to take a view on future facility life; issuance would be contingent on and proportional to actual production. However, as argued above, annual crediting would reduce investment certainty unless accompanied by a longer term commitment. And intensity-based crediting is imperfectly aligned with Australia's Paris Agreement contributions and long term goals, which require absolute emissions reductions. It would be possible for a mild improvement in emissions intensity, coupled with substantial production growth, to lead to both large volumes of crediting and an increase in Australia's absolute emissions. This risk decreases with deeper improvements in emissions intensity.

The issues raised above simply scratch the surface. Crediting below baselines is promising, but will need to be examined in great detail.

Technology-focussed co-funded opportunities

Grants programs may be a necessary supplement to a Safeguard-based crediting mechanism, able to handle electricity efficiency and clean energy generation options that address Scope 2 emissions. To attract participation, administrative and transaction costs need to be substantially lower than in the Emissions Reduction Fund. Wider participation can allow lower abatement costs and greater abatement overall, but these benefits will be partly offset if lighter rules lead to purchase of more non-additional abatement.

Grants programs have a mixed record in supporting abatement, though different observers take different views on which programs performed better. The Clean Technology Investment Program was, from Ai Group's point of view, highly successful in attracting wide participation by businesses outside the Emissions Intensive Trade Exposed category and funding efficiency and abatement projects that improved business competitiveness. However, its relatively light-touch additionality requirements were designed in the context of compensation for a cap and trade mechanism that was expected to guarantee overall emissions reductions.

Energy efficiency and extension services

Energy efficiency programs are an important tool for emissions reduction. These issues are the focus of a separate joint submission by Ai Group, the Energy Efficiency Council and the Property Council of Australia.

Knowledge, innovation and capability

Innovation is central to the delivery of viable low-, zero- and negative-emissions pathways for currently emissions-intensive activities, products and sectors. Innovation is also needed to further reduce the costs and increase the opportunities of abatement and sequestration. Australia needs durable, comprehensive and well-resourced structures and mechanisms to support innovation for a clean economy. The future of the Australian Renewable Energy Agency (ARENA) and Clean Energy Finance Corporation are important parts of this, and we note that ARENA is currently required to have spent all of its already-depleted funds by mid-2022.

As argued in our broader joint letter, investment in emissions innovation is likely to carry a cost per ton abated over the near and medium terms, and its principal benefits are lowering longer term costs. The current allocations to the CSP and CSF are solely oriented at the current nationally determined contribution for 2030, less the Government's proposed carryover, and are predicated on a low average cost of \$20 per ton abated. Funding innovation now for longer term benefits will therefore require substantial additional resources. Ai Group is working with other stakeholders to provide more detailed input to the Government on options for extending the duration, resources and scope of Australia's clean economy innovation structures.

Streamlining existing ERF processes

Ai Group is engaged with existing processes to streamline the ERF, including the potential improvement and amalgamation of multiple currently underutilised efficiency-related methodologies. However, key design features of the ERF – the auction process, payment on delivery, the contract period and make-good, for instance – involve so much transaction cost and risk that the existing system may never be attractive to a wider range of participants.

Sincerely yours,

Innes Willox

Chief Executive