15 August 2011

Committee Secretary
Senate Select Committee on New Taxes
PO Box 6100
Parliament House
Canberra ACT 2600

By email: newtaxes@aph.gov.au

Dear Secretary,

The Australian Council of Superannuation Investors (ACSI) would like to thank you for the opportunity to present a submission to the Select Committee on New Taxes.

ACSI represents the interests of 41 superannuation funds, who collectively manage over $300 billion in investments. ACSI aims to enhance sustainable long-term value for the retirement savings that are entrusted to our members as fiduciary institutional investors. We do this by representing the collective rights and interests of our members on the management of environmental, social and corporate governance (ESG) investment risk. ACSI works to achieve genuine, measurable and permanent improvements in the ESG performance of entities in which our members invest and in the ESG investment practices of our members and their investment advisors and managers.

The successful implementation and operation of any climate change policy requires the cooperation of participants from both the business and investment community. Inevitably any policy that entails potential for increase in costs and requires changes in patterns of behaviour gives rise to dissenting voices and special pleading from a range of business and political interests. However as long-term investors who maintain a fiduciary obligation to responsibly manage the retirement savings of working Australians, we consider it our responsibility to provide the Committee with our perspective on the Australian Government's proposed carbon tax or any other mechanism to put a price on carbon.

Investors' interest in climate change policy

Our members have long supported the broad scientific consensus that the global climate is changing and that these changes will continue into the future, causing higher temperatures, more drought, rising sea levels and more extreme weather. This represents severe future social and economic disruption that climate change poses, particularly in the Australian context. ACSI recognises that this disruption will threaten the stability of financial markets worldwide. As such, we are of the view that failure to act on combating the effects of climate change represents a long-term investment risk.

Whilst ACSI recognises that currently there is a heightened sense of volatility and uncertainty in global financial markets, we do not support the notion that climate change policy or carbon pricing should be delayed to accommodate for this volatility. As events over the last 100 years have highlighted, intermittent instability is a persistent feature of financial markets which is likely to increase with the growth of a globalized economy. As such, a policy that addresses a long-term issue, such as a climate change policy, should not be postponed due to comparatively short-term volatility. Moreover, in our opinion the marginal short-term cost impact to be absorbed by the economy from carbon pricing does not pose a material threat to long-term growth.

Based on the above, ACSI supports immediate action on climate change policy, ensuring that the policy achieves the following:

1. Creates market certainty and provides assurance and incentive for institutional investment in alternative sources of energy;
2. Is administered by an independent body so as to avoid political variations in its direction and objectives; and
3. Facilitates transition to a cap-and-trade emissions trading scheme that is capable of being linked to similar schemes internationally.

These requisites are consistent with previous submissions made by ACSI in regards to climate change policy. Our submission is premised on the belief that any risk that is not managed effectively creates uncertainty that is detrimental to investment markets and is ultimately borne by shareholders – the members of the superannuation funds we represent. For the effective management of climate change risk, climate change policy must give a clear market signal as to how the risk is to be mitigated, be governed by an independent, unbiased authority and have a long-term view that is consistent with commitments made to our global trading partners.

ACSI recognises that the government's proposed climate change policy has been structured so as to give effect to Australia's obligations under the Climate Change Convention and the Kyoto protocol and to take action towards meeting a long-term target of reducing national greenhouse gas emissions to 80% below 2000 levels by 2050. We are also confident that the Australian Government is not acting alone in proposing a carbon pricing mechanism, as is evidenced by initiatives taken by our international peers.

For example, the Productivity Commission's report on international action notes that seven out of Australia's top ten trading partners have adopted major policies to reduce pollution and support the growth of clean energy. While the specific policies differ between countries, the report shows that "what all emissions-reductions polices have in common is that they generally impose costs that someone must pay in order to reduce emissions"[1].

A draft carbon tax policy has been approved by the Cabinet in South Africa and is due to be implemented later this year[2]. A tax on pollution has also been instated in other economies: in the UK the Climate Change Levy dictates a differential electricity tax; in Japan a Petroleum and Coal tax is in place; and in India a carbon tax on coal producers, both domestic and foreign, has been in place since July 2010. Germany, Japan, New Zealand, South Korea and the United Kingdom (UK) have implemented national emissions trading schemes and China and the United States (US) have implemented sub-national emissions trading schemes[3].

Investor expectations of the proposed carbon tax

Given that the proposed carbon tax policy, representing an emissions trading scheme with an initially fixed price, acknowledges the importance of the requirements stated in the previous section and strives to adhere to them, ACSI recognises the Carbon Tax as an effective instrument for long-term emission reductions.

In providing its support to this policy, ACSI acknowledges the detailed research undertaken by Professor Ross Garnaut in the Climate Change Review, which asserts that:

> *"In the short-term, a fixed price can provide steadiness, when a floating price would be volatile while the scheme remained the subject of fierce dispute and threats to repeal it. It would allow firms to become familiar with compliance under the scheme, and allow Australia to move towards a quantity constraint as knowledge of the scheme and confidence in its stability expanded. Such an approach has the added benefit of gradually building industry capacity, and establishing and testing necessary institutions and administrative infrastructure"*[4] .

ACSI expects that the proposed carbon tax will successfully and uniformly implement an Australian carbon price across majority of industries. We are satisfied that the Multi-Party Climate Change Committee has engaged in extensive consultation with a cross-section of industries to determine the levels of compensation permitted for Emissions-Intensive-Trade-Exposed industries (EITE).

It should be noted that ACSI recognises the need for EITE industries to receive assistance, given that the assistance is structured so as to give these industries incentives to reduce their emissions and pursue energy efficiency measures over time. Importantly, ACSI acknowledges that investment research houses such as Deutsche Bank and MSCI have modelled the estimated carbon price impact on EITE industries (post-

[1] Productivity Commissions Research Report: *Carbon Emissions Policies in Key Economies*, Australian Government Productivity Commission, page 138.
[2] http://allafrica.com/stories/201103170151.html
[3] Productivity Commissions Research Report: *Carbon Emissions Policies in Key Economies*, Australian Government
[4] Garnaut Climate Change Review 2011, *Update Paper 6: 'Carbon pricing and reducing Australia's emissions',* Page 11

assistance) and have concluded that early carbon price impact on a significant portion of companies within these industries will be modest, at 3.5% or less of earnings[5].

As such, ACSI understands that all EITE industries, if managed accordingly, are capable of absorbing the carbon price impact without declaring significant disruptions to earnings or company stability.

In the medium-term, ACSI supports for the carbon price to have maximal coverage of industry sectors to maximise abatement opportunities and efficiencies, minimise the costs of the scheme and avoid unintended distortions. Shielding companies from a carbon price and consequently from participation in carbon emissions trading, limits their development of carbon mitigation and climate adaptation strategies that will be required for the realities of a domestic and international low-carbon economy. As such ACSI hopes that the future carbon emissions trading scheme will include agriculture, which is currently exempt from the carbon price, and entail reductions to current levels of compensation for EITE industries.

Additionally ACSI expects that the terms of the proposed carbon tax will serve to encourage relative contributions to overall emissions reductions targets from complementary measures such as renewable energy feed-in laws, energy efficiency and the protection or development of terrestrial carbon stores such as native forests and soils. We believe such contributions are necessary to accompany an emission trading scheme to drive the required structural and behavioural changes throughout the economy and society.

Investor perspective on alternatives to the carbon tax

ACSI recognises that the Coalition has proposed Direct Action policy as an alternative to the Government's Carbon Tax. Our members recognise that Direct Action policy could theoretically achieve a 5% reduction in emissions in 2020 (compared to 2000 levels), as would the Carbon Tax, satisfying Australia's commitments under the Copenhagen Accord[6]. However, as per currently available information, the mechanisms proposed by the Direct Action policy do not support the achievement of the 80% reduction of emissions on 2000 levels by 2050 as per long-term policy commitments[7].

Investors represented by ACSI also have a number of other concerns regarding the Coalitions Direct Action policy. Some of the major risks identified in the policy include[8]:

1. Direct Action policy imposes differential carbon prices on companies depending on the nature of carbon reduction activity undertaken, as opposed to a market-based mechanism such as an emissions-trading scheme. Under this scenario carbon prices are not set by the market and applied uniformly across the economy. This will result in volatility in the market and decrease the ability of companies and investors to accurately ascertain the long-term impact of carbon pricing on company operations and valuation. In addition, without facilitating an emissions-trading scheme, an Australian carbon reductions scheme will have less opportunity to cooperate with emissions trading schemes from other countries.

2. The Emissions Reductions Fund proposed by Direct Action policy awards emissions reductions activities by business and industry based on a tender process that is established and overseen by the Coalition Government. This mechanism fails to provide an independent governance authority to ensure that the tender outcomes are not influenced by political favouritism. In addition, it reduces the incentive for industries across the economy to engage in emissions reductions activities, as companies that win the tender process can undertake those activities at a lower cost.

3. Businesses will not be penalised for operating at 'business as usual' levels and small businesses and other entities not covered by the National Greenhouse and Energy Reporting Scheme (NGERS) can participate in emissions reductions activities on an 'opt in' basis. These allowances greatly remove the incentive for companies to alter existing organisational behaviour and strive for emissions reductions and also provide non-participation in emissions reductions activities as a viable alternative for all small businesses and non-NGERS reporting entities.

Currently, ACSI finds that there is not enough information regarding Direct Action policy to be certain that the above mentioned risks will not eventuate. Moreover, details policy implementation and evidence regarding the

[5] MSCI ESG Research, *Carbon Tax impact varied on trade exposed industries,* July 2011

[6] Productivity Commissions Research Report, May 2011, *Carbon Emissions Policies in Key Economies*, Australian Government

[7] The Garnaut Climate Change Review, 2008, *Chapter 12 – Targets and Trajectories*, Ross Garnaut

[8] The Coalitions Direct Action Plan, Liberal Party

viability of carbon reductions methods cited by the policy are not sufficient to provide investor confidence that Direct Action policy will be equally as effective in operation as the Carbon Tax policy in decreasing total carbon emissions.

Conclusion

ACSI and its members recognise that climate change poses a considerable risk factor for our members' investments. As such we support the Australian Government in undertaking economy-wide action to mitigate the challenges posed by climate change.

In order for regulatory action on climate change to be effective, we believe that it must create certainty in the market, encourage investments into alternative sources of energy and facilitate the eventual transition to a global emissions trading scheme. Importantly, appropriate governance and transparency is essential to the successful functioning of the proposed policy and the eventual emissions trading scheme.

ACSI is satisfied that the Government's proposed Carbon Tax policy has given consideration to these requirements and highlighted the ways in which they will be achieved. We do not have the same confidence in the Coalition's Direct Action policy based on the information currently available in the market.

As significant owners of Australian companies we acknowledge that Australian businesses and household will require transitional assistance in adapting to a new regulatory environment. However, we are of the view that the difficulties and costs endured in effective action as soon as possible will be far less than the costs likely to be borne by the economy with delayed or ineffective action.

As members of the Australian investment community, ACSI recognises the potential impact of carbon pricing on investments and the economy and fully support action by the Australian Government to progress on the management of carbon risk and transition to a low-carbon economy.

Regards,

Ann Byrne
CEO, ACSI