Hydro Tasmania
the renewable energy business

The Secretary
Senate Select Committee on Climate Policy
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Parliament House
CANBERRA ACT 2600
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8 April 2009

Dear Sir or Madam

Re: Select Committee on Climate Policy inquiry into the choice of emissions trading as the central policy to reduce Australia's carbon pollution

Thank you for the opportunity to respond to the Senate Select Committee on Climate Policy inquiry into emissions trading. Hydro Tasmania welcomes the opportunity to contribute to the development of Australian climate change policy and has previously made submissions to the Garnaut Review, CPRS Green Paper and CPRS exposure draft legislation.

Hydro Tasmania is the largest renewable energy generator in Australia, and is internationally recognised for its expertise in renewable energy. Hydro Tasmania continues to make a major contribution to the production and growth of renewable energy and reduction of greenhouse gas emissions, including through global wind energy developer Roaring 40s (a joint venture company between Hydro Tasmania and China Light and Power). Hydro Tasmania also has a Consulting business providing expertise internationally and a 51% share in Momentum Energy an accredited GreenPower electricity retailer in Victoria.

Climate change presents a physical business risk to Hydro Tasmania. As a predominantly hydropower and wind generator, Hydro Tasmania is particularly vulnerable to changes in rainfall, temperature and wind speeds that may occur as a result of climate change. The Australian policy response to climate change also represents a significant business driver to Hydro Tasmania and will greatly affect the economic sustainability of the business into the future.

With the appropriate price signals Hydro Tasmania can make an important contribution to Australia's emission reduction goals and has a number of renewable energy projects waiting to be deployed. This project pipeline includes wind farms, mini-hydro, and system enhancement opportunities. Hydro Tasmania is also involved in proving and deploying new renewable energy solutions such as: energy storage, system integration and diesel replacement solutions.

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Hydro Tasmania notes the terms of reference which are primarily to investigate:

> *the choice of emissions trading as the central policy to reduce Australia's carbon pollution, taking into account the need to:*
>
> *(i) reduce carbon pollution at the lowest economic cost;*
> *(ii) put in place long-term incentives for investment in clean energy and low-emission technology; and*
> *(iii) contribute to a global solution to climate change.*

Hydro Tasmania supports the Government's commitment to implementing emissions trading through the Carbon Pollution Reduction Scheme (CPRS) and broadly supports the design features outlined in the White Paper and exposure draft legislation. Delaying action will increase the costs of meeting future emissions reduction targets. In recognition of this, Hydro Tasmania supports a scheme design that ensures the full cost of carbon is reflected in all investment decisions as soon as practically possible, providing investment certainty and a long-term emissions reduction pathway for Australia. This should be the primary objective of the CPRS. Hydro Tasmania's response to the Select Committee's terms of reference are provided as Attachment 1.

Hydro Tasmania has been involved in consultations regarding climate change policy with the current Labor Government, the previous Howard Government and the state based National Emissions Trading Taskforce (NETT). Specifically, Hydro Tasmania has contributed to:

- the CoAG Energy Market Review 2002 (the Parer report);
- the NETTs group;
- the Howard Government's PM's Task Group on Emissions Trading;
- the Garnaut Review; and
- the CPRS Green and White Papers.

The above processes have consistently found that emissions trading should be the central policy by which Australia should reduce its carbon emissions. While Hydro Tasmania recognises the importance of this inquiry, we are concerned that it could act to delay action on climate change and at worst undermine the significant policy progress that has been made to date.

We welcome the opportunity to provide the Senate Select Committee with further information about the contents of this submission or any other issues. Should you have any queries or require further information, please contact Mr Alex Beckitt, Manager Strategic Policy (email: alex.beckitt@hydro.com.au or phone: 03 6230 5249) or Mr Colin Wain, Policy Analyst (email colin.wain@hydro.com.au or phone 03 6230 5661).

Yours faithfully

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Attachment 1 – Hydro Tasmania Submission

Executive Summary

Hydro Tasmania believes that:

- If Australia is to have a meaningful response to the climate change imperative, the full environmental and social cost of carbon must be recognised.
- An emissions trading mechanism can provide environmental certainty through the setting of scheme caps and is the most appropriate mechanism by which Australia can achieve its emissions reduction objectives within a flexible and replicable framework.
- Long-term targets should be consistent with Australia's international commitments and guided by the latest science.
- National targets and gateways beyond 2012 should be set as soon as possible. A minimum of 15 years of indicative targets are needed for industry certainty.
- Emissions trading with broad scheme coverage is the lowest cost economic instrument for greenhouse gas abatement, is recognised internationally and can facilitate linking opportunities with common tradeable units. This provides greater choice in abatement options such as international credits (e.g. through the CDM) leading to maximum economic efficiency.
- Energy efficiency, zero and low emissions electricity generation and carbon sinks can all make a strong contribution to Australia's emissions goals. To maximise the relative contribution of these options complementary support is required in addition to a carbon price.
- An emissions trading scheme produces revenue that can be reassigned to priority areas for public good by Governments. Hydro Tasmania supports the Government's proposed recycling of auction revenue to households and businesses and cites the research, development, commercialisation and export of low and zero emissions technologies as a key area where greater funding is required. Revenue should also be targeted at overcoming infrastructure impediments such as electricity transmission.
- It is unlikely that the carbon price will fully reflect the true cost of carbon from the scheme's start. A Renewable Energy Target (RET) is essential to support immediate deployment of least cost renewable energy technology until the full cost of carbon is reflected in the wholesale electricity market. A summary of the rationale and role of the expanded RET is provided later in this submission.

Further details on each of these key issues is provided below in response to the Committee's terms of reference

Addressing terms of reference 1 (a)

Emissions trading as the central policy to reduce Australia's carbon pollution

Hydro Tasmania believes that a cap and trade emissions trading scheme is preferable over alternative emissions reduction models. This was recognised by the Australian Government as far back as 1999 when the Australian Greenhouse Office released the National Emissions Trading, Discussion papers. Paper 1, titled '*establishing the boundaries'* states that:

> The primary advantages an emissions trading system offers, over other policy approaches aimed at controlling emissions, are its dependability and its potential to minimise the costs of achieving a given level of greenhouse gas abatement.

And further, on the mechanics of emissions trading, the report stated that:

> Emissions trading for instance, would ensure that emitters with the greatest scope to embrace less emission intensive activities or production techniques make a bigger contribution to the abatement task than those whose abatement options are more costly.
>
> In an emissions trading system, trade would occur between market participants who have different costs and opportunities for reducing their emission output. The emergence of a permit market would allow emitters who have exhausted their lower-cost abatement opportunities to buy additional emission permits at the prevailing price. Conversely, emitters with substantial low-cost abatement opportunities would have an incentive to adopt them, and free up permits for sale within the market. Equalising the costs of abatement across sources in this way would minimise the total costs of abatement[1].

Other approaches may not provide environmental certainty, or may not incentivise the least cost emissions reductions across the economy.

In addition to the benefits recognised in the AGO discussion papers, Hydro Tasmania also believes that emissions trading is preferable over other abatement strategies because:

- emissions trading is a transparent mechanism by which the market will set the price of carbon in relation to the supply and demand of permits in the market. An emissions tax may be more arbitrary as the carbon price will be set by Government and is likely to require ongoing intervention;
- emissions trading is consistent with current international developments;

[1] Accessed 3 April 2009 at http://www.climatechange.gov.au/archive/emissionstrading/papers/paper1/pubs/emissions_1.pdf

- it will facilitate linking opportunities with common tradeable units and provide greater choice in abatement options such as international credits (e.g. CDM) leading to maximum economic efficiency; and
- emissions trading is responsive to economic conditions. A slowdown in general economic conditions will lead to a softening of carbon prices. This offers a significant advantage over a carbon tax.

Hydro Tasmania's key positions in relation to the specific design features of the Government's proposed Carbon Pollution Reduction Scheme (CPRS) are provided at Attachment 2.

Addressing terms of reference 1 (a) ii, and 1 (b):

Long-term incentives for investment in clean energy and low-emission technology

In addition to a carbon price, Australia's response to climate change will require a portfolio of policy measures to provide strong incentives for the immediate development and deployment of the range of necessary strategies and technology solutions. These greenhouse gas emissions reduction activities include maintaining and deploying renewable energy and low emissions generation technology, developing carbon capture and storage, improving energy efficiency and increasing carbon sinks.

It is unlikely that the carbon price will fully reflect the true cost of carbon from the scheme's start. As a result, complementary measures will be needed to support immediate deployment and development of zero and low emission technologies. A Renewable Energy Target (RET) will support the deployment of least cost renewable energy technologies until the full cost of carbon is reflected in the wholesale electricity market providing long-term investment certainty to project developers.

As Australia's largest renewable energy generator and a leading renewable energy developer, Hydro Tasmania regards the proposed RET as a central component of Australia's climate change response strategy.

- An enhanced RET in parallel with the CPRS is essential if an increased share of renewable energy in the national electricity generation mix is to be realised. Implementation of the Government's pre-election policy platform will accelerate the deployment of renewable energy technologies, and therefore the earlier realisation of technology cost reductions.
- The existing Mandatory Renewable Energy Target (MRET) is proven and has demonstrated, beyond doubt, its effectiveness as a policy instrument to encourage the upgrade and refurbishment of existing renewable energy generation and the deployment of additional renewable energy generation.
- An enhanced RET can be introduced quickly, easily and at minimal incremental cost and must ensure a seamless transition from the original MRET measure.
- The RET must remain in place at least until the prevailing electricity price supports commercialisation of new renewable energy project developments.

Against this background, Australia's existing renewable energy generation base must be retained.

Addressing terms of reference 1 (a) iii, 1 (c) and 1 (d):

Australia's role in global emissions reductions

It is clear that Australia can not solve the global climate change challenge alone, particularly given that the nation currently makes a very small contribution to the total global greenhouse gas emissions. The establishment of common but differentiated international emissions reduction targets, based on the latest scientific evidence, is essential to ensure that all countries make a contribution - within their means and potential - to the global challenge.

As a prosperous and innovative country, Australia has a clear opportunity to take a leadership role and demonstrate the range of activities and technologies that can deliver global emissions reductions and ensure sustainable economic transformation. An increasing body of research and analysis is predicting that these targets and this economic transformation is readily achievable and at minimal economic cost[2]. For example:

- The Australian Business Roundtable on Climate Change analysis found that early action to reduce emissions is consistent with strong continuing economic growth (emissions reductions of 60% by 2050 could be achieved with average GDP growth of 2.1% pa, rather than 2.2% pa without action).
- ABARE's modelling shows GDP continues to grow by between 2.2-2.4% pa with emissions reduction of between 68 - 36% relative to the reference case.
- Analysis for the Climate Institute suggests achieving a 40-100% reduction in net emissions by 2050 (including through purchase of international emissions credits) is consistent with strong economic growth. GDP and GNP increase more than three fold over the 45 years to 2050 across all scenarios, and real GDP grows from less than $1 trillion today to over $3 trillion in 2050 in all scenarios.

Hydro Tasmania recognises the difficulty for the Australian Government in setting long-term emissions targets. Nonetheless, long term emission goals must be consistent with Australia's international obligations and guided by the latest international science. Setting an appropriate emissions cap through an emissions trading scheme can allow Australia to make a fair and equitable contribution to the global emissions reduction effort. Furthermore, emissions trading architecture allows future caps to be adjusted and for the market to price emissions over time accordingly.

Australia's contribution to international negotiations and action on climate change will also be furthered through the design of a scheme that encourages international linking. The proposed CPRS will allow the recognition of international credits such as those through the Clean Development Mechanism and potentially credits from avoided deforestation. This can encourage abatement in other countries and foster a coordinated global effort.

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[2] *Deep Cuts in Greenhouse Gas Emissions - Economic, Social and Environmental Impacts for Australia* ,Report to the Business Roundtable on Climate Change, The Allen Consulting Group, March 2006; *The heat is on,* Report from the Energy Futures Forum, CSIRO, December 2006; *Leader, Follower or Free Rider - The economic impacts of different Australian emission targets,* Report to the Climate Institute, December 2007

Attachment 2

Hydro Tasmania's key positions on the CPRS are as follows:

- The national targets and gateways should be set as soon as possible with a minimum of 15 years of indicative targets needed for industry certainty.
- Hydro Tasmania supports full banking of permits under the CPRS. Very limited borrowing should be permitted but only to the extent that it allows for balancing of any administrative oversight of liability.
- A price cap is unnecessary when considered in the context of other design features including international linkages. Hydro Tasmania believes that the scheme shortfall penalty should be set sufficiently high above the marginal cost of emissions abatement so that it is very unlikely to be met.
- Hydro Tasmania welcomes the decision that liable entities carrying permit shortfalls will need to 'make-good' their shortfall. This will preserve the environmental integrity of the scheme.
- Hydro Tasmania supports auctioning as the principle method of distributing emission permits. The allocation of free permits for transitional assistance must avoid perverse incentives to continue operation beyond current planned lifecycle and ensure a genuine transition to lower carbon intensity.
- Hydro Tasmania supports the Government's proposed recycling of auction revenue to households and businesses and cites the research, development, commercialisation and export of low and zero emissions technologies as a key area where greater funding is required. Revenue should also be targeted at overcoming infrastructure impediments such as electricity transmission.
- The voluntary purchase and consumption of renewable energy by an individual or company provides distinct benefits to society. Products such as GreenPower should be recognised under the CPRS. Additionally, there is an impediment to encouraging entities to undertake additional voluntary action – in particular:
    - The current design of NGERS does not empower companies to reduce their (Scope 2) emissions attributed to electricity consumption. This methodology does not accommodate the fact that a business may be sourcing some/all of their electricity from renewable sources (the businesses own generator, purchased Green Power or contracted zero emission energy). In calculating emissions from consumed electricity NGERS simply applies the State average emissions factor for all electricity consumed.
    - This is a serious limitation of NGERS accounting methodology. Clearly NGERS would need to address any associated greenhouse accounting issues and also require entities to disclose some possibly sensitive contractual information for this issue to be fully addressed.