The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600
Email: economics.sen@aph.gov.au,

Dear Committee Secretary:

RE: Inquiry into the exposure drafts of the legislation to implement the Carbon Pollution Reduction Scheme

We are a group of concerned young Australians, deeply alarmed by the threat that climate change poses to our world. We are passionate about ensuring Australia responds appropriately to this crisis, and hence welcome the opportunity to provide a submission to the Economics Standing Committee regarding the draft legislation to implement the Carbon Pollution Reduction Scheme (CPRS).

We believe that the proposed CPRS will not adequately achieve meaningful reductions in carbon emissions, nor will it establish a sound economic framework to transition Australia's economy into the future. Our major points of concern, which we will discuss in turn are:

1. The CPRS proposes targets for carbon emissions that are based on political compromise, not scientific or indeed economic evidence and advice
2. The CPRS over-compensates emissions-intensive trade-exposed (EITE) industries and strongly-affected industries, thus unfairly over-burdening the rest of the economy
3. The CPRS unjustifiably compensates coal-fired electricity generators
4. The CPRS does not effectively promote action to reduce carbon emissions, and delaying action on this issue will ultimately result in greater costs to Australia.

1: Targets for Carbon Emission Reductions

The issue of Climate Change has rightly caused great concern within the general population and within the political community. The Commonwealth Government, along with the States and Territories, have put in place a range of measures to tackle this problem; from improved building codes, to incentives for investment by householders and business in green technology, to reducing the public sector's carbon footprint and mandatory targets for renewable energy. It is widely accepted that to achieve meaningful reductions in carbon emissions, a cost should be placed on the emission of carbon into the atmosphere, and the Commonwealth Government has proposed to do this within the framework of an Emissions Trading Scheme (ETS).

There is an inherent risk in selecting an ETS to tackle climate change. The fact that the scheme overlays all other initiatives in the area of climate change and dictates our ability as a nation to transition to a lower carbon intensity economy, at least until 2020, means that the target for emissions reductions is extremely important. An overly ambitious target can cause economic harm, while an unambitious or small target provides no incentive for change and does nothing to contribute to effective structural adjustments to the economy.

The target set forward by the IPCC for emissions reductions by 2020, for developed nations, was 25-40% (IPCC AR4 Working Group III Report). Whilst Australia will face a challenge in meeting these targets due to population growth, it should be noted that this should not affect our commitment to this target. This is because:

- We currently have the highest developed economy per capita emissions (Australia Institute, 2004), so should have the most room to reduce.
- The targets were set with consideration to future population growth. Each developed country is allocated their emissions based on current population, the only fair model, so we cannot escape ‘doing our bit’ because of a desire for population growth.
- Subsequent scientific evidence to the 2007 IPCC report suggests that our abatement targets should be greater than originally suggested due to more rapid than expected warming.

The Australian government has proposed a target range of between a 5 and 15% reduction in emissions by 2020. We believe that these targets are drastically inadequate for three main reasons:

- Whilst the top end of the target may be within the required range for stabilisation of world emissions at 550ppm, we are effectively conceding that we will not commit to 450ppm stabilisation and are therefore setting this and future generations up for the consequences of failure. Furthermore, it should be noted that the required targets to avert many environmental, economic and social disasters caused by climate change can only be estimated. Therefore to set targets below the absolute minimum best guess is, we believe, extremely irresponsible.
- As many have noted, including Senator Penny Wong and Sir Nicholas Stern, it appears more cost effective to take significant action on climate change now. This would involve the setting of targets in the 25-40% range at a minimum.
- The choice of a relatively modest target will mean that the scheme is not effective in providing incentive for movement towards a new economy. Furthermore, with the significant protections inherent in the scheme, a low target may mean the scheme effectively collapses, as was experienced in Europe.

As scientific understanding of climate change trends expands, the impact of predicted warming on our environment, economy and society continues to exceed all expectations. Examples of this include the increases in severe weather events, such as the recent heatwaves, floods and bushfires experienced throughout Australia. It is clear that to avoid many of the dangerous results of warming, a 450ppm approach should be adopted. This approach is consistent with the basic principles of risk management.

In short, great uncertainty exists as to exactly the level of warming which will cause certain catastrophic ecosystem damage. However, it is certain that any warming beyond 1°C will have adverse impacts in particular to the Australian economy and ecosystem, as well as to almost all parts of the globe (IPCC AR4 Working Group II Report - Figure SPM.2.). Therefore to limit the increase of the loss of agricultural productivity, the scarcity of water resources, the loss of tourism icons, the increased frequency and intensity of severe weather and fire events and other potential impacts in Australia (IPCC

AR4 Working Group II Report - Section 11.4), we as young people consider that setting the most stringent possible targets is the only sensible option.

2: Compensation of Emissions-Intensive Trade-Exposed Industries (EITEI), and strongly-affected industries

In contrast to the assistance package for other sectors, we acknowledge that a well-designed assistance program for emissions-intensive trade-exposed industries is necessary and in keeping with the economic and environmental aims of the CPRS. Having said that, there are several elements of the implementation chosen in the CPRS that cause us significant concern.

Treasury modeling

The purpose of EITEI assistance, from the Government's perspective and from an economic perspective, is to prevent "carbon leakage." Advice from Treasury (Australia's Low Pollution Future, Box 6.7) indicates that noticeable carbon leakage is not predicted to occur at the carbon price predicted for the "CPRS -5" scenario even in the total absence of EITEI assistance. Though not stated explicitly in Treasury's publication, it is reasonable to assume that if, due to the adoption of a comprehensive global emissions reduction agreement, a higher emissions reduction target was adopted in Australia and a higher carbon price resulted, that the likelihood of carbon leakage would be greatly diminished by the international effects of said global agreement. Treasury also notes that where EITEI assistance is implemented, it comes at the cost of other sectors of other Australian economies and to the detriment of the aggregate efficiency of the sector (ALPF, Box 6.7). Even the Government's CPRS White Paper outlines several compelling arguments for limiting EITEI assistance to the minimum necessary (White Paper pp 12-11 to 12-12).

Despite evidence that little assistance is required under the proposed emissions reduction targets, the CPRS Exposure Draft Legislation outlines a large assistance program – corresponding to around 25% of all emissions permits being required for fulfillment of EITEI assistance obligations (White Paper Policy Position 12.11). This leaves significant scope for reduction of the quantum of assistance supplied and/or adoption of greater emissions reduction targets that might result in a higher carbon price.

Mechanism

Professor Garnaut (Garnaut Climate Change Review, Box 14.5) identifies that the function of EITEI assistance should not be to offset the entire cost of compliance with an emissions trading scheme, as this leads to an unsustainable level of production. Rather, such assistance should offset the costs of the system only to the extent that it supports a level of production that is sustainable in the long run. Assistance should be given only to the extent that the current price of a good differs from a price that fully reflects the associated carbon costs. The EITEI assistance program outlined in the Exposure Draft Legislation commentary fails this test by providing near-complete cost offsetting for the most exposed industries.

Further failure is also evident by the fact that there is no legislative mechanism to remove assistance to EITE industries in the context of a global agreement on emissions reductions. Ongoing assistance in such a situation could be considered a contravention of Australia's international trade obligations and is therefore inconsistent with the Government's own objectives for the assistance program (Commentary Item 4.4).

Failure to incorporate a natural or legislative mechanism for the reduction and/or cessation of EITEI assistance in the context of increasing global emissions abatement will only serve to encourage similar failures in future policies of other nations, endangering Australia's ability to terminate the assistance program. This could leave the Australian government with an unsustainable burden, but more importantly could create a scenario in which significant international effort must be dedicated to simultaneous phasing-out of assistance programs around the world. One must only consider the unenviable task of the World Trade Organisation to realise the importance of avoiding such a situation. To address this shortcoming, the definition of emissions-intensive trade-exposed industries could be modified to take account of the proportion of goods in the global marketplace that are sourced from economic regions in which the price of the good reflects carbon pricing. Such a mechanism would be effective without imposing any additional burden on businesses seeking assistance.

3: Compensation of coal-fired electricity generators

In the CPRS White Paper, the Government justified its assistance to coal-fired electricity generators on the basis that operators in this sector will have significant "sunk capital" in the form of plant for which capital investment was committed before the impact of a carbon constrained economic environment could be factored into the investment decision (Chapter 13, pp 13-1 to 13-5). We strongly reject this as a justification for the provision of government assistance to the sector. Based on official commentary to the CPRS Exposure Draft Legislation (Item 5.11) it appears the Government considers that the investment decision-making landscape changed significantly on 3 June 2007 with the then Prime Minister's announcement of the Government's intent to implement an emissions trading scheme by 2012. The reality, however, is that inevitability of a carbon-constrained economy has been evident since the adoption of the Kyoto Protocol in December 1997, or indeed since the treaty was drafted in June 1992. Similarly, the establishment of the IPCC by the UN in 1988 represents a significant and visible indication of long-term future constraints on greenhouse gas emissions. In this context, it is clear that the announcement of an Australian emissions trading scheme in June 2007 merely represents the natural progression of the issue from a highly uncertain, long term risk (1990) to a short term risk with much greater certainty as to the nature, price and scope of its impacts.

Survey of the available research literature suggests that capital investment decisions in the electricity generation are carried out on a 20 year horizon. While investors in the 1990s would not have been able to specifically price the impacts of the proposed Scheme in the context of investment decisions, the reality of a long term risk of this nature as demonstrated above should have been reflected in the risk premium demanded of these projects. As young Australians, it is nearly impossible for us to accept that investment decision-makers did not or could not account for this risk when we, as primary schoolers in the early 1990s, could have told you that coal-fired electricity generation was a primary cause of global warming and that our methods of electricity generation needed to change as soon as possible.

In the official commentary to the Exposure Draft Legislation, the Government subtly changes its rationale for the assistance program, citing the possibility of failures in investor confidence in the sector that may be disproportionate to the risks associated with the actual emissions of particular projects (Items 5.7, 5.8). We equally consider this inadequate justification for government assistance. While the Government's assessment that investor sentiment is likely to be affected by the level of extreme losses more so than the average level of loss in the electricity generation sector, we consider that job losses due to plant closure rather than loss of asset value on paper will be the major cause of such investor irrationality. The proposed compensation scheme, therefore, is likely to merely delay such inevitabilities and will be of little net benefit to the nation. Furthermore, while we agree with the Government's assertion that continuing investment in the electricity generation sector is important, we reject the notion that a collapse in investor confidence in coal-fired electricity generation will translate into a collapse in confidence in the electricity supply sector as a whole, as there is already clear differentiation between sub-sectors (e.g. fossil-fuel, renewable energy) pre-existing in investors' minds. We ask the Committee to consider the inverse proposal – that indications, such as this assistance program, that the fossil-fuel lobby has disproportionate influence over the CPRS will result in sub-optimal investment in low emissions technologies, particularly in the electricity generation sector.

Aside from ideological arguments surrounding the rationale for government assistance to coal-fired electricity generators, we are also strongly critical of the effects that such assistance will have on the broader economy and the effectiveness of the CPRS. The provision of assistance to the stationary energy sector has no demonstrable economic benefit – its effectiveness in preventing economic harm is highly subjective. On the other hand, its provision does reduce the revenue the government receives from the auction of permits. This is revenue that would otherwise be available through a variety of policy instruments as assistance to households or businesses to implement energy efficiency measures, or to fund the research and development of low emissions technologies. These in turn will create downward pressure on the carbon price, which is a demonstrably positive economic outcome.

The assistance program proposed for the coal-fired electricity generation sector also increases the complexity of the scheme and reduces its transparency. These are crucial characteristics of the scheme. The first will cause inefficiencies and have an economic cost. The second undermines public confidence in the scheme and creates uncertainty for businesses.

It is our strongly held belief that for both a strong economy and for a strong emissions trading scheme that is most likely to achieve its aims and achieve them with simplicity and efficiency, that assistance to coal-fired electricity generators must be removed from the scheme. We must also express our disappointment that this element of policy was included in the scheme at all, given that it was not recommended nor considered beneficial by the independent advice received from either Treasury or Professor Garnaut. One of the most damaging effects of this assistance program is to create a mindset of costs. The entire justification for assistance to parts of the stationary energy sector is based on a view that this scheme is a cost to the Australian economy. This is far from the truth. A well designed and implemented emissions trading scheme is akin to infrastructure spending - it is absolutely necessary for the future viability and growth of the economy. The Australian public, and indeed the world's leaders in the lead-up to COP15, need the Australian Government to reinforce this perspective and to highlight the economic opportunities that the CPRS brings and the attitude of economic prudence from which it is borne. Assistance to the coal-fired electricity generation scheme shows that even if the government may say words to this effect, they do not believe them.

4: Delay of Effective Action Increases Cost

Experience shows that a poorly designed ETS with weak targets can prove harmful in the fight to mitigate emissions. Under the CPRS, there are multiple measures designed to ensure that business is able to cope with the transition to a carbon-priced economy. These include considerable compensation, particularly to EITE industries, the inclusion of domestic offsets, a price ceiling on permits, the ability to purchase overseas ETS permits and international offsets, the exclusion of some sectors where accounting is difficult (e.g. agriculture) and artificial price fixing (e.g. for petrol prices). Under this environment, where significant protections have been implemented, the effectiveness and efficiency of any ETS is undermined. Aside from the constraints that such measures impose on the market mechanism of an ETS, allowing unlimited international offsets has the potential to direct significant amounts of investment away from Australia. This will have short term economic impacts in Australia while also resulting in sub-optimal investment in the structural adjustments to the Australian economy that ultimately will be necessary in the long term. Contrary to the alarmist warnings, Australia will benefit from an effective CPRS with targets of at least 25%, but up to 40%. This course of action can help the globe to avert dangerous climate change, with its significant economic consequences, and allow Australia to benefit from a new 'greener' global economy.

The Stern Review stated that "*the overall costs and risks of climate change will be equivalent to losing at least 5% of global GDP each year now and forever*." When considering a broader range of risks and costs, the review found that this figure could rise to 20% or more. In contrast, the cost of action to reduce the impacts of climate change would be less than 1% of global GDP. In light of these figures, it is obvious that early action to reduce carbon emission and combat climate change is highly beneficial. In Australia our economy has been heavily reliant on traditional, often heavily polluting industries, such as mining, automotive manufacturing and coal mining. However, we have seen that many of these industries have been failing, as we attempt to compete with developing nations. Therefore, we must view an emissions trading scheme, together with the global economic crisis as an opportunity to transition to a new, greener economy. Such a transition will enable Australia to be a world leader in new technology and environmental management. These industries would likely profit from a price on carbon, here and overseas, and would focus on the strength of Australia - innovation. Employment in highly skilled areas would enable us to differentiate ourselves from low-cost competitors and position us perfectly to respond to opportunities in a climate-change-affected global economy.

Australia's Vehicle to a Low Pollution Future

With the release of the CPRS draft exposure legislation, Senator Penny Wong described the CPRS as Australia's vehicle to a low pollution future. Demands for a stronger scheme were likened to wishing for that vehicle to be a Ferrari. Two key characteristics of a Ferrari come to mind in this context – a Ferrari is out of reach and is extravagant. A strong emissions trading scheme is neither of these things. Both our own Treasury modeling and various international studies show that emissions reductions to levels in the range of 25-40% below 1990 emissions are affordable, economically prudent, and necessary – not extravagant. In our view, the proposed scheme is not only inadequate, but has several structural defects – akin to trying to drive our vehicle without tyres and with the hand-brake applied. These defects are not beyond redemption. However it requires an act of national leadership – on the part of all of our political, business and community leaders – to recognize the opportunities associated with action on climate change. Our emissions trading scheme must highlight these opportunities, and provide our community with the motivation, power and freedom to pursue them. This cannot be achieved with a burdensome scheme pre-occupied with the welfare of our nation's past; it must be done with eyes focused firmly on our bright future.

This is a moment of great opportunity for Australia. Please do not let it pass us by.

Yours sincerely,

Rebekah Christensen

Deanna Howland

Iain Murchland

Rachel Murchland

Rowan Steele