



Energy Retailers Association
of Australia Incorporated

28 September 2007

Committee Secretary
Senate Economics Committee
Parliament House
Canberra ACT 2600
economics.sen@aph.gov.au

Dear Sir/Madam

RE: Inquiry into the National Market Driven Energy Efficiency Target Bill 2007

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide comment to the Inquiry into the National Market Driven Energy Efficiency Target Bill 2007 (the Inquiry).

While ERAA supports the purpose of the Bill "... to promote the adoption of greater energy efficiencies and cost effective greenhouse gas abatement ..." it remains fundamentally opposed to the use of an energy efficiency trading scheme/target to fulfil this purpose. In the ERAA's view, untapped energy efficiency opportunities are most efficiently and effectively promoted via some sort of incentive (for both development and deployment) rather than a penalty. The ERAA believes the use of a trading scheme would be redundant post the introduction of a comprehensive national emissions trading scheme and essentially would double count the externality cost of carbon. The ERAA has put forward an alternative energy efficiency policy measure to the proposed Victorian Energy Efficiency Target, which is conceptually analogous to the Bill (attached to this submission for the Committee's consideration).

Please find our submission enclosed (which is essentially the background to the ERAA Climate Change Policy Position)¹.

If needed, I would be happy to meet with the members committee to discuss the issues raised in this submission. In the mean time, should you have any queries please feel free to contact myself on (02) 94376180, or alternatively, the Chair of the ERAA's Sustainable Working Group, Mr Steven Wright on (03) 8628 1183.

Yours sincerely,

Transmitted via email]

Cameron O'Reilly

Executive Director

Energy Retailers Association of Australia

¹ ERAA Climate Change Position is available at http://www.eraa.com.au/db_uploads/ERAAPositiononClimateChangePolicyinAustraliav1Sept2004.pdf

Introduction

The ERAA is an independent association established in 2003 to represent the interests of retailers of electricity and gas across Australia.

Membership is comprised of businesses operating in retail electricity and gas markets in the ACT, New South Wales, Queensland, South Australia, Tasmania, Victoria and Western Australia.

The ERAA's member companies purchase gas and electricity from the wholesale gas and electricity markets and on sell it to end use customers. As well as the retailing of electricity and gas, our members also source renewable electricity, administer the compliance with all greenhouse abatement schemes and provide customers with energy efficiency services.

The ERAA's 12 members collectively sell electricity to over 9.25 million customers and gas to over 3.2 million customers across Australia.

The purpose of the ERAA is to:

- provide a public voice on all energy retail matters to government and industry bodies;
- access key decision makers to affect national energy policy; and
- ensure efficient development and implementation of national energy policy and markets.

Position on Climate Change Policy

Central to ERAA's position on climate change is the strong contention that the long-term interests of the community are best served by a comprehensive, national approach to climate change policy.

However existing arrangements, including the Federal Government Mandatory Renewable Energy Target, the New South Wales Government Gas Abatement Scheme, the Queensland Government 13 per cent Gas Scheme and the Victorian Government Renewable Energy Target represent a highly disparate and fragmented approach to addressing the challenges of climate change. These arrangements impose a premium on emissions abatement well above least cost which is ultimately born by energy consumers and the wider community.

It is the ERAA's view that governments of Australia should have the long-term policy objective of establishing a single national carbon abatement scheme that results in the least cost outcomes for consumers and the broader community. Such a scheme would create a clear, long-term carbon signal across all sectors of the economy (including energy) to act as an incentive for consumers to conserve energy and for producers to invest in cleaner energy technologies. An explicit market-based carbon signal, complimented by an effective and efficient research and development policy, would drive the appropriate balance between the economic benefits of energy and the protection of the environment.

As a first step, the harmonisation of existing arrangements should be pursued where possible (particularly if new jurisdiction-specific schemes are to be introduced). The joint jurisdictional approach to national emissions trading is an important interim step toward a truly national approach to carbon abatement (involving the Federal Government). The final step involves the phasing out of existing schemes over the long-term while maintaining investment certainty and compensating the owners of affected assets via adequate allocation arrangements.

The ERAA believes the recently announced National Clean Energy Target, intended to replace existing and proposed jurisdiction-based schemes, is a step in the right direction.

There are 5 principles the ERAA considers fundamental to guiding the development of a comprehensive national climate change policy:

1. *effectiveness and efficiency* - actual reductions in emissions occur at the lowest cost with markets, and not government, determining the mix of technologies used;
2. *equity and transparency* - the burden of reducing emissions is allocated across the community in a fair and open manner;
3. *administrative simplicity* - the scheme employed to reduce emissions minimises the complexity and cost for participants;
4. *regulatory certainty* - the policy framework is robust and stable, establishing a long term price signal for carbon which can be passed through regulated sectors; and
5. *international compatibility* - the scheme implemented in Australia is capable of being linked to a global framework or predominant international schemes.

The ERAA considers all proposed climate change policies, such as the National Market Driven Energy Efficiency Target Bill (the Bill) in light of their consistency with these principles.

National Market Driven Energy Efficiency Target Bill

While the ERAA supports the purpose of the Bill "... to promote the adoption of greater energy efficiencies and cost effective greenhouse gas abatement ..." it is fundamentally opposed to the use of an energy efficiency trading scheme/target to fulfil this purpose. The ERAA believes that use of such a scheme is an inappropriate policy tool for the task.

Underpinning the ERAA's approach to Climate Change Policy is the concept of efficient public policy. An efficient and effective policy framework is designed to target key sources of market failure pertinent to the policy problem. The sources of market failure relevant to climate change are:

1. Negative externality - a price for energy that does not reflect its environmental damage, fails to reflect the environmental benefit of zero/low emission technologies, distorting energy consumption and investment decisions away from the deployment and development of cleaner technologies and in favour of emission intensive technologies).

2. Information good - the inability of innovators of zero/low emission technologies to fully recoup the costs of risky, knowledge intensive R&D and commercialisation activities reduces the incentive for investment in their development and deployment and reduces potential 'spill-over' benefits available.²

Judicious policy intervention is required to 'deploy' existing zero/low emission and energy efficiency technologies and to 'develop' potential zero/low emission and energy efficiency technologies to achieve the policy goal optimally.³ However, if ultimately either the deployment or development of related policy intervention is not predicated on rectifying market failure(s), the overall community's interests are unlikely to be improved by the policy intervention (even if some individual sectors benefits as a result). This would amount to 'government failure'; a condition where the policy goal is pursued at a level above least cost because of policy distortions.

The efficiency and effectiveness of a national emissions trading scheme has been well established by the Jurisdictions' National Emissions Trading Taskforce's Discussion Paper, "Possible Design for a National Greenhouse Gas Emissions Trading Scheme" (2006); and by the Prime Ministerial Task Group on Emissions Trading Report, "Report of the Task Group on Emissions Trading" (2007).

An explicit price on carbon is best created via a national emissions trading scheme, which addresses the 'negative externality' directly; and goes some of the way to ameliorating 'information good' problem. The introduction of a price on carbon improves the investment economics of all zero/low emission technologies (existing and potential) relative to competing emission intensive technologies:

- Deployment - as the price of carbon increases existing zero/low emission and energy efficiency technologies are progressively dispatched into the energy market, displacing emission intensive competitors at the margin and expanding the size of the industry (enabling further cost advantages to the extent that scale economies exist for various technologies).
- Development - as the price of carbon increases, ex-ante returns to innovators of potential zero/low emission and energy efficiency technologies also increase, encouraging greater investment in typically risky R&D and commercialisation activities (and therefore greater spill-over benefits for the industry and the economy).

² 'Spillovers' are returns to investment in knowledge that flow to other parties and cannot be recouped by the innovator/investor. See Arrow, K. 1962, *Economic welfare and the allocation of resources for invention*, in N. Rosenberg (ed.), *The economics of technological change* (1971).

³ 'Development' of technology refers to the innovation process, commencing with research and development and concluding with demonstration and commercialization. 'Deployment' of technology refers to the actual dispatch of technology into the market as a supplier of energy. Note; there may be 'feedback' between deployment and development (for example, if deployment increases learning and experience, which drives further innovation etc.)

However, a price on carbon is unlikely to overcome both sources of market failure adequately. This is because sunk (development) costs associated with R&D and commercialisation are unlikely to be able to be recouped via a price on carbon alone, as opposed to the variable costs of deploying existing technologies, which a price on carbon compensates for directly. This is so for at least three reasons:

- Political resistance – the imposition of very high carbon charges would have to be agreed to and announced well in advanced of deployment and actual emissions reductions (which separates the political ‘pain’ from the potential reward by decades);
- Sovereign risk – investors face significant sovereign risk when attempting to make risky investments on the back of governments’ long term promises and would discount their value (even if such promises were actually made by governments); and,
- Dynamic inconsistency – even if governments could tolerate imposing high carbon charges, politically there is a strong incentive for governments to renege on long term promises, and lower the carbon charge, after the technology has been developed (and the investment sunk) because only variable costs would require some type of incentive post development, to ensure deployment (and emission reductions). In the absence of a ‘perfect’ system of property rights the incentive to, and level of investment in, R&D and commercialisation activities will be lower than optimal even with a price on carbon.

Increasing R&D and commercialisation support is also widely acknowledged as being required to complete the approach to climate change policy. A number of international studies attest to the proposition that energy related R&D is too low given the potential costs of climate change.⁴

Conclusion

The ERAA’s believes untapped energy efficiency opportunities are most efficiently and effectively promoted with the provision of an incentive (for both development and deployment) rather than a penalty.

The use of a trading scheme is redundant post the introduction of a comprehensive national emissions trading scheme and as it essentially double counts the externality cost of carbon. The ERAA has put forward an alternative energy efficiency policy measure to the proposed Victorian Energy Efficiency Target, which is conceptually analogous to the Bill. It has been attached to this submission for the Committee’s consideration.

⁴ See International Energy Agency (2006), Energy Technology Perspectives – Scenarios and Strategies to 2050; and Stern, N. (2006), Stern Review: Report on the Economics of Climate Change, Cambridge University Press.



Energy Retailers Association of Australia

**Subsidy versus penalty - alternative
energy efficiency policy measure**

Current Victorian Energy Efficiency Target Proposal

Proposed VEET Scheme



Information gaps:

- Actual target / abatement modelling results?
- Mandated portfolio approach (as per UK model)?
- Customer segment coverage – residential/SME?
- Scheme expansion in other jurisdictions/ other sectors?
- How to develop VEET penalty/price cap in the absence of ETS details?

Retailer concerns with current proposal

- **Perverse incentives/inefficiencies**

- Separation of control (customers) and liability (retailers)
- May reduce some retailers' competitive advantage (based on EE)
- Barrier to new entry (particularly small entrants)
- Unfunded liability which equates to a tax on retailers without guaranteed recovery
- Does not target high consumption users directly
- High administrative cost per abatement transaction
- Poor trading liquidity (especially if state-based and residential energy only)
- Delivers relatively little 'additional' EE abatement diversity (i.e. low hanging fruit being achieved by Govt programmes, e.g. Sustainability Victoria rebates for insulation etc)

- **Inconsistent with ETS**

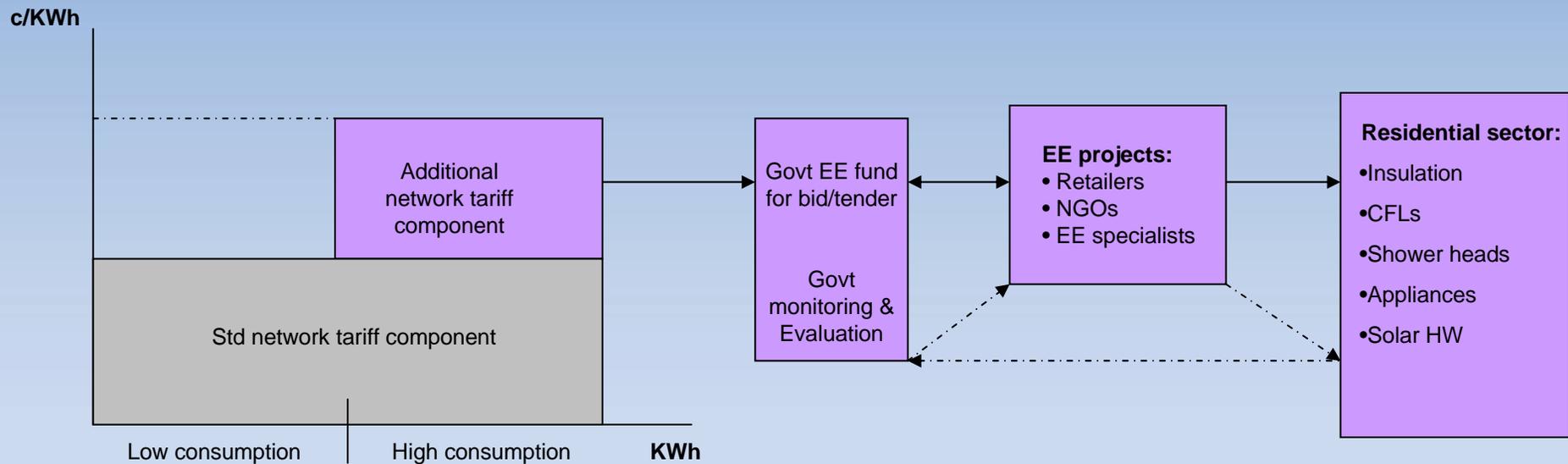
- ETS already provides a price signal for EE investment (double pricing of same emissions)
- Very complex as an interim measure to drive EE

- **Not effective policy tool to address information failure**

- Does not focus on education to address awareness/behavioural issues
- EE without education does not mitigate the 'rebound effect'

Alternative Proposal: EE Network Fund

Proposed alternative



How are the funds raised?

- Both low and high consumption users benefit from the fund (according to EE potential in their homes)
- But, scheme to raises funds from high consumption users only, using step network tariff
 - also creates natural price incentive to use less energy (e.g. Water)
- Low income households contribute zero/less to the fund (i.e. no increase in tariff below consumption threshold)
- Administered through regulated network (full regulated recover via DUOS)
- Fund quantum can be varied from year to year (depending on requirement)

How are the funds allocated?

- Participants bid/tender for the fund annually (e.g. retailers, NGOs, EE specialist service providers)
- Government selects best projects based on abatement potential, social impact and project diversity
- Successful participants implement EE projects to achieve agreed outcomes
- Government audits (or imposes self-audit requirements) successful participants EE initiatives
- A proportion of the fund can be set aside for education and awareness programmes (which are essential to real/sustained improvements in residential EE)

Advantages over VEET

Pro-competitive to energy retailer market

- No barrier to new retailer entrants to Victorian market
- Does not eliminate competitive advantage for retailers with natural EE differentiation
- Does not impose liability on party with no control over behaviour

Flexible and administratively efficient

- Independent of and complementary to ETS (i.e. can target information failure)
- Effective as short term or long term policy measure
- High abatement value per tender transaction (compared to trading system)
- Can easily target different customer segments/EE options in different years

Effective mechanism for achieving Govt's policy objective

- Tender selection allows for 'pick and choose' approach to achieve abatement target and other social goals
- Price/funding incentive structure consistent with user pays efficiency and social equity
- Makes funds available for education and awareness (at the heart of information failure)