AUSTRALIAN INDUSTRY
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Mr John Hawkins
Committee Secretary
Senate Standing Committee on Economics
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Parliament House
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Dear Mr Hawkins,

The Australian Industry Group (Ai Group) welcomes the opportunity to provide this submission to the Inquiry into the *Renewable Energy (Electricity) Amendment Bill 2009* and a related bill.

The Australian Industry Group

Ai Group is a leading industry association in Australia and is committed to helping Australian industry meet the challenge of change. Our focus is on building competitive industries through global integration, human capital development, productive workplace relations practices, infrastructure development and innovation. The recently completed merger of the Engineering Employers Association South Australia with Ai Group further builds our strong national representation.

Ai Group members operate small, medium and large businesses, and employ around 750,000 staff in a number of industry sectors. Many members are in energy intensive industries, and the reliability, affordability and environmental impact of energy is of key concern. Ai Group is closely affiliated with more than 50 other employer groups in Australia alone and directly manages a number of those organisations, including the Australian Constructors Association. Together, Ai Group and its affiliates represent the interests of approximately 60,000 businesses which employ in excess of 1.2 million staff across Australia and the world.

Summary

Ai Group strongly supports public assistance for research and development in the area of renewable energy and low-emissions energy alternatives. As with other areas of research and development, there are clear market failures arising from the inability of private industry to fully capture the benefits of R&D expenditure. As a result, the market left to its own devices will not generate an optimum level of R&D expenditure. In view of the potential efficient contribution of renewable and low-emission sources to emissions reduction, Ai Group believes this area of R&D should attract particular public support.

Ai Group also supports the powerful and enduring boost to the renewable and low-emissions energy sector that will be provided by the adoption of the proposed Carbon Pollution Reduction Scheme.

Ai Group does not, however, support the Renewable Energy Target (RET). It is an expensive and ineffectual second-best to a comprehensive and efficient emissions trading scheme (ETS).

If the government proceeds with the implementation of the RET, vulnerable industries must be shielded from its impact on the same basis as under the Carbon Pollution Reduction Scheme (CPRS).

This shielding should be designed in a way that does not impose additional increases in energy costs on businesses that do not qualify for shielding.

Least cost abatement

Adherence to the principle of least-cost abatement is essential if Australia is to achieve both strong environmental outcomes and continued prosperity. This is not an argument against ambition, but against inefficiency; every dollar that we spend on energy is a dollar we cannot spend on education, health or families.

Least cost abatement is best achieved by the decentralised decisions of thousands of individual Australian energy producers and energy consumers responding to a carbon price according to their own means, goals and circumstances. The proposed RET would partly circumvent this by having the Government decide exactly how much renewable energy is required. This is at odds with the Government's nominal support for the principles of least cost abatement and the use of additional policies only to correct genuine market failures not addressed by the CPRS.

The Renewable Energy Target is a poor second best

The further development and commercial uptake of renewable energy will be essential if Australia is to reduce its carbon emissions to the extent scientists say is necessary to safeguard against climate change. However, Ai Group does not support using the RET to subsidise the renewable energy sector.

The fundamental principle underpinning Ai Group's position on climate change policy is that reductions in emissions of greenhouse gases should be achieved at the lowest possible cost. Ai Group therefore supports a broad-based market approach in the form of a well-designed ETS to drive lowest-cost emissions abatement across the whole economy. If the proposed CPRS is passed, with appropriate amendments to assist affected industries during the transition, there will be no need for the RET at all.

Research undertaken by the Productivity Commission[1] has shown that the enactment of an expanded RET in addition to an ETS would:

i. Not achieve any additional abatement;
ii. Only impose additional costs; and
iii. Likely lead to higher electricity prices.

Any emissions permits "freed up" by renewable energy investment are available for purchase and banking or use by others. If the RET requires energy investments more expensive than the carbon price can justify, its effect will simply be to increase whole-of-economy costs and crowd out cheaper forms of abatement. The Garnaut review identified a strong risk that the RET would cannibalise the CPRS, and put the additional costs at between $750 million and $1.1 billion per annum by 2020.[2] Perversely, there would be much less gas-fired generation (relatively cheap and relatively low emissions) and somewhat more coal-fired generation.[3]

Even if there were to be no CPRS, it is unlikely that the RET would be an adequate substitute. It would mandate unnecessarily high-cost abatement and leave Australians much worse off than under an ETS alone. Modelling undertaken by the Treasury found that the average cost per tonne of CO_2-e of emissions reduction from the RET would be around three times the average expected permit price under the CPRS from 2010 to 2020.[4]

Australia needs a better, broader, more efficient emissions reduction policy. The RET should be abandoned, and the Government and the Opposition should concentrate their efforts on amending and passing the CPRS.

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[1] Productivity Commission, *What Role for Policies to Supplement an Emissions Trading Scheme? Submission to the Garnaut Climate Change* Review (2008) x.
[2] Ross Garnaut, *The Garnaut Climate Change Review* (2008) 356.
[3] Ibid.
[4] Treasury, *Australia's Low Pollution Future: The Economics of Climate Change Mitigation* (2008) 181.

Addressing Impacts on Industry

If an expanded RET is implemented nonetheless, there are several key issues that must be addressed to minimise the harm to the Australian economy. The most important of these is to ensure that vulnerable industries are adequately shielded and that this is done in a way that does not impose additional increases in electricity costs on businesses that are not shielded.

EITE Activities

The RET should not impose a competitive disadvantage on Australian energy-intensive trade-exposed industries (EITEs, also referred to as RET-affected trade-exposed or RATEs). The effect of the RET will be to significantly increase electricity prices, even more so than the CPRS.[5] The inability of EITEs to pass on the increased operating costs resulting from the RET will diminish their international competitiveness. The Bill includes an exemption for the EITE activities, but ties it to the definition in and the passage of the CPRS legislation. As currently drafted, if there is no CPRS there will be no protection for EITEs from the impact of the RET. The RET must not be implemented without this protection.

There is a sound argument that the definitions and thresholds for compensation or exemption under the CPRS and the RET should be consistent. Both measures will impact the same EITE industries through significantly higher energy prices and the rationale for assistance is identical. It would be absurd for some industries to be protected from the one but not the other, or to impose further regulatory confusion through different tests for assistance.

The most important outstanding issue with the CPRS is ensuring that industry is provided with measures necessary to remain competitive. Therefore, the

[5] The price impact would not be simply cumulative. However, the RET will require significantly more renewables investment than the CPRS carbon price would justify, with a proportionate further increase to the electricity price.

Senate should carefully consider its approach to industry measures under the RET. If it were to amend the legislation to include a particular set of compensation arrangements for the RET, it would essentially have agreed to arrangements for the CPRS as well. The Senate must recognise that it is dealing with the same issue in both the CPRS and RET contexts. Either can be decided first, but both must be consistent.

Non-EITE Activities

The measures aimed at reducing the burden of higher electricity prices on emissions intensive trade exposed businesses are not associated with a reduction in overall renewable energy targets. Nor are they associated with any funding from outside of the operation of the RET. As a result the partial exemptions granted to EITE industries will be borne largely by other purchasers of electricity.

The extra costs imposed on non-EITE businesses (and in respect of the non-EITE activities of businesses that do qualify under EITE provisions) are of particular concern for trade exposed businesses. These businesses will not be able to pass additional costs to their customers either in the domestic market or in export markets. There are numerous industries and activities that are trade exposed, that do not qualify for EITE measures and for which electricity is a significant input. These include, but are not limited to, businesses and activities in food processing industries; in metals fabrication; in plastics and chemical industries; and in businesses that make building products, containers, paper and paper products.

As the proposed RET currently stands, these businesses and activities stand to be doubly damaged by the RET. They will be damaged by the increase in electricity prices that will result from the adoption of a renewable energy target itself and they will be further damaged by the way the partial exemption for EITE activities is designed. Under the current proposals, the costs of the much-needed shielding proposed for EITE industries will be shifted onto other businesses. Where these businesses are exposed to international competition - whether in the domestic market or in export markets – they will not be able to pass these costs on. This will reduce their competitiveness, reduce the level of investment in Australia and reduce the level of employment in these businesses.

Not only do these businesses fail to qualify for the partial exemption under the RET and for EITE measures under the CPRS, but they are also being called on to absorb extra costs because of the poor design of the partial exemption measures proposed by the RET.

R&D into Renewable and Low Emissions Energy Alternatives

Ai Group maintains that there is an important role for governments in supporting research, development and commercialisation of promising renewable and low-emission energy technologies.

A central element in this support is the adoption of an emissions trading scheme that will impose a cost on greenhouse gas emissions. Renewable and low emissions energy projects will become more attractive both for direct investment and as candidates for research and development expenditure.

Ai Group acknowledges that the CPRS alone will fail to adequately stimulate R&D into renewable and low-emissions energy. As with R&D more generally, the inability of the private sector to fully capture the benefits of R&D in these areas suggests that the market (even corrected for the costs of greenhouse gas emissions) will produce a sub-optimal level of R&D.

There is, therefore, a strong case for public support for R&D. Ai Group supports such public support whether through direct funding of research or through support for R&D undertaken in the private sector.

We note, however, that the proposed RET would do little to support research into renewable energy. It would not repair companies' inability to capture the spillover benefits of such research and it would therefore leave market failures surrounding investment in this area of R&D uncorrected.

Instead the RET is a production subsidy that will encourage investment in non-commercial renewable energy projects. If anything, this is likely to draw private sector funds and effort away from the far more important endeavour of research and development into ways to make renewable, and other low-emission energy sources, commercially viable in the longer term.

Distortions

Subsidies like the RET are very prone to generate economic distortions and to unfairly and irrationally disadvantage some sections of the community.

Some illustrations of this are evident in the proposed treatment under the RET of solar credits and hot water systems.

The proposed RET includes a Solar Credits multiplier to encourage uptake of small solar panels. The multiplier means that a small solar panel generates up to five times more Renewable Energy Certificates than its energy generation would otherwise allow. Therefore to the extent that it is taken up the multiplier will prevent the RET from achieving its actual generation targets in any year until the multiplier lapses in 2015-16. Small solar panels installed because of the RET would effectively prevent the installation of a larger quantity of more cost effective renewable generation. While noting this distortion, Ai Group strongly opposes any compensatory increase to the RET annual targets, as this would further increase the costs borne by industry and the broader economy.

The treatment of hot water systems under the current MRET has led to concerns from some industry stakeholders that high-efficiency gas water heaters are being unfairly disadvantaged against other higher-emissions systems in some circumstances. Such concerns are likely to be greatly magnified under a strengthened RET.

Should these concerns be addressed, close consultation with all affected industry stakeholders will be required on a careful revision of the *Renewable Energy (Electricity) Regulations 2001*. Revision of the relevant Australian Standards may also be necessary. If changes are agreed to aspects of the existing MRET regulations, businesses that have made investments on the basis of the current arrangements will need sufficient time to adjust, and impacts upon them should be taken into account.

Distortions like these will not arise or worsen if the RET is not enacted. Under a pure CPRS approach, carbon pricing would affect the competitiveness of every form of water heating in proportion to its emissions (whether through electricity use or gas burning) as compared to the available alternatives. Households and businesses would be free to choose the option that imposed least cost on themselves and the environment.

If you require further information, please contact me at vivienne.filling@aigroup.asn.au, or on 03 9867 0111.

Yours sincerely,

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