

Mr Blair Comley
Secretary, Department of Climate Change & Energy Efficiency
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Dear Mr Comley

The Department of Climate Change and Energy Efficiency (DCCEE) has sought written submissions on the proposed architecture and implementation arrangements for a carbon pricing mechanism. This submission sets out the Energy Efficiency Council's views on the statement released by the Multi-Party Climate Change Committee on 24 February 2011.

The Energy Efficiency Council is the peak body for companies that provide energy efficiency services and products to businesses and governments. Energy efficiency is major and rapidly growing industry, and the Council's members have a global turnover exceeding \$200 billion per annum.

The Energy Efficiency Council strongly supports the introduction of a carbon price in Australia as a critical tool to help Australian businesses to adjust and thrive in a global low carbon economy. The Council believes that the principles outlined by the Multi-Party Climate Change Committee on 24 February are broadly appropriate as starting points for the development of a carbon pricing mechanism. The effectiveness of the final scheme will depend on a myriad of design details that have yet to be announced.

The energy efficiency sector requires a carbon price mechanism that is:

- **Certain, stable and gives price transparency** over several decades, to support investment in long-lived assets. In particular, the Council strongly opposes winding back a carbon price in the future, as this would cause significant damage to the energy efficiency sector.
- **A broad incentive** to support investment in cost-effective abatement, whether that abatement occurs in energy supply or demand management.
- **Environmentally effective** and meets the Australian Government's goal to reduce emissions by 5 to 25 percent below 2000 levels by 2020.
- **Accompanied by other energy efficiency policies.** A carbon price will only address one of the barriers that impede cost-effective energy efficiency. Therefore, a carbon price will need to be accompanied by critical complementary policies.

Energy efficiency and the role of a carbon price

Increasing the efficiency of energy use in Australia improves the welfare of households and increases the global competitiveness of Australia's businesses. When energy prices increase it makes economic sense to invest in improved efficiency to reduce expenditure on energy. Given the vast, untapped potential for improved energy efficiency in Australia, investing in energy efficiency could save the economy \$5 billion per annum by 2020.¹

Investing in energy efficiency, cogeneration and other demand-side measures can also deliver wider social benefits by substantially reducing expenditure on the electricity network, reducing both energy bills and electricity prices. The Townsville Solar City project has managed to reduce peak demand on Magnetic Island by over 20 per cent, deferring \$17 million investment on an undersea cable by at least eight years.

Although energy efficiency is justified on economic grounds alone, it is also the largest source of greenhouse gas abatement over the next decade. Existing energy efficiency

¹ ClimateWorks 2010, *A Low Carbon Growth Plan for Australia*, ClimateWorks Australia, Melbourne.

policies will deliver 40 per cent of Australia's business-as-usual abatement to 2020², and the International Energy Agency estimates that, with the right policies, energy efficiency could deliver 65 per cent of the abatement needed to deliver an aggressive 2020 global greenhouse gas reduction target.

However, there are a range of barriers that impede investment in privately and socially beneficial levels of energy efficiency. The policies that support energy efficiency can be grouped into three categories:

1. Helping people invest in privately cost-effective energy efficiency
2. Ensuring private price signals and regulations reflect social benefits
3. Ensuring private price signals and regulations reflect environmental impacts, particularly greenhouse gas emissions

Policies in each of these three categories address different barriers. A carbon price is a vital tool to address the carbon externality, but will have limited impact in addressing the information barriers that prevent people from investing in privately cost-effective energy efficiency. Therefore, the Energy Efficiency Council recommends a carbon price as part of a suite of policies to drive energy efficiency.

Architecture of a carbon price mechanism

The Council is comfortable with a carbon price that starts with a fixed price to provide stability in the early period and then transitions to a cap and trade scheme. However, this transitional arrangement must be structured in a way that provides business with certainty about the long-term trajectory, in order to support investment in long-lived assets. The Council further recommends that the government investigate a price floor for the cap-and-trade phase of the mechanism, as this could provide additional certainty for business³.

Starting date: The Council supports the carbon price mechanism commencing in 1 July 2012, and recommends against any delay to the introduction of a carbon price. Many companies are waiting for clarity on the carbon price before they make investments in energy efficiency and low-carbon energy.

Length of fixed price period: The Council has no comment at this time on the length of the fixed price period. The Council is comfortable with the price increasing annually at a pre-determined rate.

Starting price: The Energy Efficiency Council notes that the carbon price must be set at a sufficiently high level to meet the Government's target to reduce emissions by 5 to 25 percent below 2000 levels by 2020. The Council does not recommend a specific price at this time.

Transition arrangements: The Council is comfortable with the overall recommendations of the transition arrangements proposed by the Multi-Party Climate Change Committee, but notes that the details of the cap-and-trade scheme need to be announced well in advance of the transition, in order to provide certainty for business. The Council recommends that the 2020 target for the scheme be locked in as soon as possible.

Coverage: The Council recommends that the carbon price mechanism cover all forms of stationary energy, fugitive emissions and industrial processes. This is necessary to prevent perverse outcomes, as some processes that could reduce industrial emissions are relatively energy intensive, and vice versa.

² Department of Climate Change and Energy Efficiency 2010, Australia's emissions projections 2010, DCCEE, Canberra. (p23)

³ Wood, P.J. and Jotzo, F. 2010, "Price floors for emissions trading", FEEM Working Paper No. 118.2009.

In order to provide certainty and stability, the Council also recommends that agriculture be excluded from coverage until such time as agricultural emissions can be measured and verified robustly. Including agricultural emissions without robust measurement could result in oversupply of offsets and collapse in the permit price, affecting the viability of other emission-reducing projects.

International linking: The Council recommends that companies should only be allowed to use limited quantities of international emission units to meet their liabilities at the beginning of the cap-and-trade phase of the carbon price mechanism. The proportion of liabilities that can be met from international emission units could then increased. This would provide additional stability for the Australian scheme while other international schemes are maturing, and will help the Australian economy start adjusting to a global low-carbon economy, rather than simply funding abatement to occur overseas.

Assistance: The Council supports appropriate support to Emissions-Intensive Trade-Exposed (EITE) industries, noting that support mechanism should be developed from first principles and based on evidence, rather than political grandstanding. The Council looks forward to working closely with the Department of Climate Change and Energy Efficiency (DCCEE) to ensure that any windfall clause for EITE industries is designed in a way to maintain incentives for EITEs to reduce their emissions.

Complementary measures

As noted, a carbon price only addresses one of a number of barriers to energy efficiency. Complementary measures are required to address the multiple barriers to energy efficiency for a range of policy goals, including energy affordability, improved competitiveness and reducing the cost of adjusting to a low carbon economy. The Council recommends the following complementary measures for introduction in 2011:

- Energy efficiency in Australian Government operations
- Allocating part of the revenue from a carbon price to a Climate Change Action Fund to help businesses invest in cogeneration and energy efficiency.
- Energy market reform, including a thorough review of the National Electricity Market and the following immediate actions:
 - o A National Energy Saving Initiative
 - o A cogeneration ombudsman and clear rules for connecting cogeneration
 - o A goal to reduce the energy intensity of the economy by 30 percent by 2020

These complementary policies are discussed in more detail in Attachment A.

If you have any questions please contact the Energy Efficiency Council on 03 8327 8422.

Yours sincerely



Rob Murray-Leach,
Chief Executive Officer

Attachment 1: Energy efficiency policy priorities

The policies that support energy efficiency can also be grouped into three categories:

- Helping people invest in privately cost-effective energy efficiency
- Ensuring private price signals and regulations reflect social benefits
- Ensuring private price signals and regulations reflect environmental impacts, particularly greenhouse gas emissions.

Each of these categories of policies addresses a different set of barriers. A carbon price is a critical tool to address the carbon externality, but will have limited impact in addressing the information barriers that prevent people from investing in privately cost-effective energy efficiency. Therefore, Australia needs a suite of policies to drive energy efficiency, including:

- Energy efficiency in Australian Government operations
- Allocating part of the revenue from a carbon price to a Climate Change Action Fund to help businesses invest in cogeneration and energy efficiency.
- Energy market reform, including a thorough review of the National Electricity Market and the following immediate actions:
 - o A National Energy Saving Initiative
 - o A cogeneration ombudsman and clear rules for connecting cogeneration
 - o A goal to reduce the energy intensity of the economy by 30 percent by 2020

The Council's recommendations are set out in more detail below, according to the category of policy that they fit into.

Helping people invest in privately cost-effective energy efficiency

Homes and businesses in Australia can save money now through energy efficiency, but are impeded by market failures that include skill gaps, information asymmetry, misaligned incentives, first-mover disadvantage and behavioural, organisational and cultural factors. These barriers interact to impede industry development, which acts as a further barrier. A well-designed package of measures can drive self-sustaining market-transformation.

Policies that can address these market-failures include information programs like the Energy Efficiency Opportunities (EEO) program, Minimum Energy Performance Standards (MEPS) and transitional incentive schemes like the Tax Breaks for Green Buildings that make companies pay attention to energy efficiency opportunities.

The Council recommends three urgent policies for 2011 that address these barriers:

- Improving the energy efficiency of Commonwealth Government operations. The Government can save at least \$75 million a year by improving the energy efficiency of the buildings that agencies own or occupy. Energy efficiency in government operations will protect the budget from rising energy prices, create jobs and drive energy efficiency in the private-sector.
- Providing transitional incentives to help companies invest in energy efficiency and cogeneration. The EEO program shows that energy users under-invest in energy efficiency and cogeneration projects that have attractive rates of return (e.g. 20 per cent) but involve innovative application of existing technologies or take longer than two years to pay back. The Council recommends that the Government establish a national Energy Saving Initiative and allocate auction revenue from the carbon price to a fund to help businesses invest in energy efficiency and cogeneration.

- Allocating part of the auction revenue from a carbon price to support training, accreditation and information tools.

Ensuring private price signals and regulations reflect social benefits

Investing in energy efficiency and distributed generation can provide additional grid capacity, often at lower cost than supply-side infrastructure. The Townsville Solar City project has managed to reduce peak demand on Magnetic Island by over 20 per cent, deferring \$17 million investment on an undersea cable by at least eight years.

However, as recently noted by Professor Garnaut, there are significant flaws in the regulation of the National Electricity Market (NEM) that encourage over-investment in supply-side infrastructure, particularly distribution and transmission networks, and discourage investment managing demand growth. Furthermore, as network companies are regional monopolies they can set the terms for connecting cogeneration units to their network, stymieing other companies from creating additional grid capacity.

These flaws result in higher energy bills and under-investment in energy efficiency and cogeneration. NEM reform is critical, and needs to be progressed through a thorough review of the NEM and an immediate suite of actions. The Council endorses the Prime Minister's Task Group on Energy Efficiency's proposals on NEM reform, and recommends:

1. Replacing the three existing state energy efficiency schemes with a National Energy Saving Initiative.
2. Establishing a cogeneration ombudsman and clear rules for connecting cogeneration to the network. Some of these reforms can be implemented quickly, but some reforms will take time to finalise, such as ensuring that cogeneration providers are paid for the full network services that they provide. Therefore, the Council recommends using some of the carbon price auction revenue to ensure that cogeneration is competitive while NEM reform is being progressed.
3. A thorough review of the NEM to ensure that we invest in energy efficiency and cogeneration when they are cheaper than investing in supply-side options. Ideally, this review would be lead by an independent expert supported by:
 - A Secretariat that includes international experts and staff from the Australian Energy Market Commission; and
 - An Advisory Board that includes groups such as the Energy Efficiency Council and Energy Users Association of Australia.
4. A national goal to reduce the energy intensity of the economy by 30 percent by 2020, in order to communicate with the public and drive NEM reform.

Ensuring private price signals and regulations reflect carbon costs

The costs of energy generation and energy use do not currently reflect the environmental externalities of greenhouse gas emissions. The Energy Efficiency Council strongly supports the Australian Government's intent to introduce carbon price legislation in 2011 as the best way to address this externality.

The Council recommends allocating auction revenue from a carbon price to a fund to help businesses invest in energy efficiency and cogeneration (The 'Climate Change Action Fund' (CCAF)). This fund would operate for around 5 years to help companies transition to a low-carbon economy and would provide support for cogeneration while the multiple barriers in the NEM are tackled.

The Carbon Pollution Reduction Scheme White Paper proposed a \$2.15 billion CCAF which included \$1.4 billion over 5 years to help businesses and community groups to invest in energy efficiency and other low-emission technologies. The Council recommends that this stream is increased from \$1.4 billion to at least \$2.5 billion to support energy

efficiency and cogeneration, with a particular focus on the industrial sector. This would be a minor reallocation of carbon price revenue and the \$2.5 billion fund would provide more support to EITEs to adjust to a low-carbon future than untied support.

The CCAF also included a separate stream of \$130 million over 5 years to provide information on how to respond to a carbon price. If this stream was given additional funding and expanded to support training, accreditation and information tools it could help to address significant skill gaps, create jobs and build the economy.