Business Council of Australia

Submission to the Climate Change Authority regarding the Caps and Targets Review Issues Paper

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The Business Council of Australia (BCA) brings together the chief executives of more than 100 of Australia's leading companies, whose vision is for Australia to be the best place in the world in which to live, learn, work and do business.

About this submission

The BCA is making this submission in response to the release of the *Caps and Targets Review Issues Paper* by the Climate Change Authority. The submission provides comments on both the proposed approach to the review and makes a series of recommendations in relation to setting Australia's emissions reduction goals.

Key points

This review by the Climate Change Authority (CCA) can make an important contribution to framing Australia's international obligations in greenhouse gas emission reduction over the next 40 years.

To ensure the review can make such a contribution, the following matters should be reflected in the work of the CCA during the review.

The CCA should consider confining its recommendations on Australia's commitments under different global emission response scenarios to defining appropriate quantitative emission limitation and reduction obligations (QELROs) and caps, and refrain from nominating trajectories. The problem with recommending trajectories for Australian emissions is that they imply a level of market interference that is unlikely to be least-cost and therefore not warranted.

The review has taken as its starting point the scenario of Australia contributing to global emissions reductions that limit average global warming to 2 degrees Celsius and the Clean Energy Act 2011 legislated target for Australia of -80% on 2000 greenhouse gas emissions by 2050.

It is the view of the BCA that the review should not be restricted to this one scenario, given the limited progress in international negotiations and actual policies in place in the major emitting countries.

It is clear that the country pledges initiated in Cancun and carried through to Doha are not sufficient to launch the world on a 2 degree Celsius trajectory of emissions. Also, as the various country submissions to the recent second session of the Ad Hoc Working Group on the Durban Platform for Enhanced Action demonstrate, there is no evidence that international negotiations, whether within or outside the UNFCCC, will see a coordinated global agreement by 2015 that will meet this 2 degree Celsius aspiration.

In light of these realities, the CCA needs to incorporate into its review scenarios that fall short of the starting point proposed in the issues paper.

In order to make sensible recommendations about Australia's fair share of global burden, other less ambitious 'targets', budgets and caps will need to be considered – recommending that Australia unilaterally continue on a trajectory to 80% below 2000 emissions by 2050, while the rest of the world lags behind would not be "economically efficient, environmentally effective, equitable and in the national interest".[1] Such a course of action would not represent Australia's fair share of the global burden and would result in an over-allocation of Australian resources to mitigation relative to adaptation.

Computable general equilibrium modelling should be used by the CCA in this review to guide an assessment of Australia's comparable burden relative to that of other countries. This has long been central to Australia's negotiating position.

In the context of this review, the key reason to undertake economic modelling is to assess the economic and social implications of different Australia commitments and budgets, relative to those pledged by other similarly wealthy countries – not in isolation as would appear to be the approach

[1] Commonwealth of Australia, *Caps and Targets Review Issues Paper*, Climate Change Authority, Canberra, April 2013, p. 3.

of the CCA which concentrates on estimating domestic economic implications, rather than comparative international economic implications or against some assumed coordinated action as was done by Treasury for the CPRS Bill and Clean Energy Act.

While the review will assess whether the conditions exist that would warrant Australia moving beyond its -5% commitment, the BCA is of the view that the requirements spelt out by Australia in the Copenhagen Accord for a move beyond -5% and the conditions outlined in the issues paper have not been met:

> Australia will reduce its greenhouse gas (GHG) emissions by 25 per cent compared with 2000 levels by 2020 if the world agrees to an ambitious global deal capable of stabilizing levels of GHGs in the atmosphere at 450 ppm carbon dioxide equivalent (CO2eq) or lower. Australia will unconditionally reduce its emissions by 5 per cent compared with 2000 levels by 2020 and by up to 15 per cent by 2020 if there is a global agreement which falls short of securing atmospheric stabilization at 450 ppm CO2 eq under which major developing economies commit to substantially restraining their emissions and advanced economies take on commitments comparable to Australia's.[2]

Notwithstanding that nations may publicly justify their commitments in terms of some of the principles and approaches suggested in the issues paper, ultimately all nations will select their contribution to the global burden based on national self-interest. In a practical and domestic political sense in every nation, this boils down to 'willingness to pay'. In a comparative sense, the BCA judges that Australians are willing to pay as much as Europeans, Americans, Canadians and Japanese, as measured by the impact on per capita GDP or GNI.

The BCA believes the lack of discussion on this aspect of the international negotiations is a significant shortcoming of the issues paper. Indeed, the principles in Box 5 and the approaches in Table 4 miss completely the main drivers of international negotiations over the last 20 years – namely, the relative economic burden of the national 'targets' and budgets, and in particular their trade implications.

Key recommendations

In this submission, the BCA recommends that:

- in assessing the scope of international commitment to global emissions reduction, the review only take account of what other countries are actually doing or have pledged via concrete, verifiable steps, as distinct from any stated political aspirations
- further, in assessing what countries are actually doing, the review should consider the actual impacts of these particular policies on businesses in those countries
- Australia maintain its current commitment to net emissions of -5% of 2000 levels by 2020 as there is no evidence to suggest that any of the conditions needed to trigger consideration of an increase to that commitment have been met
- in addition to a scenario that would potentially meet the aspiration of restricting the increase in global warming to 2 degrees Celsius, the CCA needs to consider a range of less ambitious international action scenarios that require Australia's fair share of the international burden to be less stringent than an emissions 'target' of -80% of 2000 levels by 2050
- the CCA adopt an approach to determining Australia's fair share of any global emissions budget that equates the economic costs that Australians are expected to pay with those of similar wealth such as, in the immediate term, Americans, Europeans, Canadians and Japanese and in the longer term emerging economies such as China, the Republic of Korea, India, Mexico and Brazil
- the caps for covered and uncovered sectors of an emissions trading scheme should reflect the relative shares of the business-as-usual emissions to avoid a disproportionate shifting of the abatement burden onto the covered sectors

[2] Compilation of economy-wide emission reduction targets to be implemented by Parties included in Annex I to the Convention, http://unfccc.int/resource/docs/2011/sb/eng/inf01r01.pdf.

- the review concentrates on the task of defining potential global emission budgets and Australia's comparable burden under those budgets, and leaves the issue of future policies and measures for another review.

Introduction

The BCA welcomes the opportunity to contribute to the national discussion that will help frame Australia's international obligations in greenhouse gas emissions reduction over the next 40 years.

The BCA can bring to the table the experience of representation on Australian Government delegations to the UNFCCC from 1995, the year of the Berlin Mandate, to 2007 and, in the context of negotiations to reach a comprehensive and coordinated global agreement, participation by our Deputy Chief Executive, Ms Maria Tarrant, in all the annual meetings of the Parties to the Convention and the Kyoto Protocol from 2007 to 2012.

Within a broader framework of energy policy principles (see Attachment A), the BCA advocates that climate change policies should:

- ensure Australia acts as part of a global response that includes all major emitters of greenhouse gas emissions
- ensure Australia's emissions reduction commitments are premised on both Australia's contributions to global emissions and the possible impacts on Australia in the absence of global action
- contribute to a reduction in global greenhouse emissions relative to a business-as-usual outlook
- support market-based responses to enable lowest-cost outcomes
- include arrangements to fully offset the impacts on trade-exposed industries in the absence of policies in competitor countries placing equivalent costs on traded products
- facilitate the long-term and smooth transition of the electricity sector to lower-emissions technologies
- provide investment certainty to enterprises and investors
- support the research and development necessary to identify technology solutions – including low-emissions technologies
- support energy efficiency at the household and industry level
- build Australia's adaptation capabilities.

The first three of these principles are specific to the issues raised by the Climate Change Authority in its issues paper about Australia's part in a global agreement, while others are relevant to the issues around setting caps for the Australian emissions trading scheme.

Also relevant is the research undertaken by Port Jackson Partners for the BCA in 2007 on what approach Australia should take to setting its emissions reduction targets.

The BCA 2007 report *Setting Achievable Emissions Targets for Australia* included detailed discussions of the key issues. The recommendations of that report, set out in Exhibit 1, remain relevant to the current review of caps and targets being undertaken by the Climate Change Authority.

Exhibit 1: Setting Achievable Emissions Targets for Australia

There is not currently an agreement among all or most nations to reduce long-term emissions by set amounts in future decades. Without this underpinning, any targets that Australia sets must therefore weigh a range of factors:

- any targets should be credible environmentally in that Australia should seek to take its appropriate share of the burden to reduce emissions to provide the reductions that the now prevailing science suggests the world requires
- the Australian targets need to take account of what other countries are actually doing, as distinct from any stated "political" aspirations that are not backed by concrete steps
- any targets must be technically feasible
- the community needs to know the broadly expected cost to the economy of meeting the targets, and needs to see these costs as acceptable
- in addition, if Australia establishes an emissions trading scheme before its competitors the cost of the scheme in the initial years at least will need to be kept to modest levels
- most important, any set of targets must create a "virtuous circle of achievement" in that we can sensibly meet the targets in the initial years (with effort), which will bring credibility to the whole process in general and the harder to meet later year targets in particular.

Source: 'Establishing Credible Targets for Greenhouse Gas Reduction', report prepared by Port Jackson Partners Limited and incorporated in *Setting Achievable Emissions Targets for Australia*, Business Council of Australia, May 2007.

Within the context of the BCA principles and the 2007 report, the remainder of this submission addresses the matters raised in the issues paper and follows the chapters of that paper.

The CCA's approach, context and scope

The BCA broadly agrees that it is a practical starting point for this review that:

> The Authority accepts the view that it is in Australia's interests to support global emissions reductions to limit global average warming to 2 degrees Celsius or less. Additional starting points are Australia's long term target to reduce emissions to 80 per cent below 2000 levels by 2050, and the policy action of Australian governments at all levels to reduce emissions. The 2050 target and policy measures (which include the carbon price) are among the 'givens' for this Review.[3]
> (issues paper, p. vii)

This starting point scenario recognises:

- the scientific advice that supports global emissions reductions to limit global average warming to 2 degrees Celsius
- that the Clean Energy Act 2011 legislates for Australia the 80% below year 2000 by 2050 net emissions "target" and that, notwithstanding that the Act may be abolished by a future government, this 'target' would remain relevant if international agreement is reached that is consistent with the 2 degree Celsius aspiration
- both the government and the Coalition support market mechanisms, either through a price on emissions or a price on emission abatement, although the BCA contends that, in their current detailed design, neither the government's nor the Coalition's approaches are economically efficient, environmentally effective or equitable.

[3] *Caps and Targets Review Issues Paper*, p. vii.

Importantly, however, the CCA will fall short of meeting its remit if this review confines itself to this single starting point scenario.

It is clear that the country pledges initiated in Cancun and carried through to Doha are not sufficient to launch the world on a 2 degree Celsius trajectory of emissions, which all studies argue requires a peaking of global emissions by 2020.[4]

Further, as the various country submissions to the recent second session of the Ad Hoc Working Group on the Durban Platform for Enhanced Action demonstrate[5], there is no evidence that international negotiations, whether within or outside the UNFCCC, will see a coordinated global agreement by 2015 that will meet this 2 degree Celsius aspiration.

In these real world circumstances, and consistent with its approach to risk and uncertainty, the CCA needs to incorporate into its review scenarios that fall short of the starting point scenario.

In particular, in order to make sensible recommendations about Australia's fair share of global burden, other less ambitious 'targets', budgets and caps will need to be considered – recommending that Australia unilaterally continue on a trajectory to 80% below 2000 emissions by 2050, while the rest of the world lags behind would not be "economically efficient, environmentally effective, equitable and in the national interest".[6] Such a course of action would not represent Australia's fair share of the global burden and would result in an over-allocation of Australian resources to mitigation relative to adaptation.

In relation to the CCA's approach to other matters, the BCA makes the following points:

- the BCA strongly supports the CCA's approach to look beyond 2020 to 2030 and 2050 – business needs policy frameworks that look forward at least 20 years, which is the 'bankable' timeframe for major low emission and emission abatement investment
- we would encourage the CCA to have an expanded discussion about the use of the word 'target' to describe Australia's commitment under the Kyoto Protocol and beyond. Indeed, it would be better to replace the word 'target' with 'commitment'. There is considerable community confusion about the use of 'target' to describe Australia's international commitments. A useful role for the CCA would be to remove this confusion. Further, there is a significant difference in terms of cost burden (Australia's fair share of global emission reduction) between the -5% net commitment the government supports and the -5% absolute commitment the Coalition supports, the latter being higher in cost as it involves all emission abatement within Australia
- the CCA should consider confining its recommendations on Australia's commitments under different global emission response scenarios to defining appropriate quantitative emission limitation and reduction obligations (QELROs) and caps, and refrain from nominating trajectories. The problem with recommending trajectories for Australian emissions is that they imply a level of market interference that is unlikely to be least-cost and therefore not warranted.

The BCA notes that in relation to the discussion about 'targets' and trajectories, the continued use of Figure 5 ('Australia's Emissions Since 1990'), and outlook to 2050 in Chapter 2 of the issues paper compounds community confusion and misunderstandings. Figure 5, which has been widely used by the government, wrongly purports to illustrate Australia's emissions 'targets' and trajectories under a range of commitments. To the extent that a Figure is used to explain the commitments, modelling should be incorporated to show, for illustrative purposes, the difference between the commitment and Australia's projected emissions under a net emissions approach versus a domestic abatement only approach – in other words the difference between international trading and non-trading.

Figure 5 also demonstrates the BCA's contention that the 80 per cent below 2000 levels by 2050 end point is only likely to be relevant to the -25% commitment to 2020. From the perspective of any agreement possibly to be made in 2015, -80% is incompatible, in terms of economic efficiency and

[4] The UNFCCC, the IEA and the World Bank have all released analyses of the pledges that support this conclusion.
[5] http://unfccc.int/bodies/awg/items/7398.php
[6] *Caps and Targets Review Issues Paper*, p. 3.

equitable burden sharing, with the -5% commitment and up to -15% pledge made by Australia – higher emission end points for 2050 are required for these alternative scenarios.

In relation to the historical analysis of policies and measures, the BCA would encourage the CCA to not only examine the underlying drivers of the changes in Australia's emissions and the contribution of different policy measures (such as the renewable energy target, carbon pricing mechanism, energy efficiency opportunities) over time, but to also update the work of the Productivity Commission and the Grattan Institute on the estimated costs of each policy in terms of $/t of abatement.

The BCA seeks more clarity around the CCA's intentions with regard to recommendations on policy. On the one hand, the issues paper states that: "The Authority may identify opportunities to improve the existing policy portfolio, and areas where gaps or weaknesses hinder Australia's progress" yet the paper also states that "The Authority does not intend to examine the merits of the carbon pricing mechanism, nor its detailed design, in this Review" (p. 11).

For the purposes of this review, the BCA recommends that the CCA focus on appropriate QELROs and caps for Australia consistent with a range of international scenarios, and in that context a factual analysis of the contribution of policies to date. This review does not need to assess the policy requirements to meet the different levels of Australian commitments.

Australia's emissions reduction goals

Timeframes

The BCA agrees that the review should examine longer timeframes and different international action scenarios over those timeframes. Timeframes to 2020, 2030 and 2050 would be appropriate. However, the BCA does not agree that a single 2050 Australian commitment of 80% below 2000 emissions levels be used as this would be inconsistent with the range of international scenarios. Rather, different 2050 commitments consistent with lesser international action should also be considered in the context of Australia's equitable share of the burden.

Further, as already noted, the BCA considers that it would not be appropriate to recommend Australian emission trajectories. The CCA should however differentiate between Australian net commitments and absolute commitments such that the impact of the different approaches can be understood.

Accounting

The BCA agrees that the default approach is for Australia's commitments to be defined in terms of Kyoto Protocol rules, including land use, land use change and forestry (LULUCF) but ignoring international aviation and shipping.

However, the analysis of global action should also recognise that the majority of Parties to the UNFCCC have not committed to these rules. In these circumstances, the CCA may wish to make recommendations on the conditions that Australia might adopt in order to accept, say, Californian emissions trading scheme units as eligible to meet Australia's international commitments.

The approach to the carry-over of credits between periods should be consistent with the terms of the international agreement that has been entered into. In the context of the Kyoto Protocol, that agreement allows for carry-over. The commitments entered into at the beginning of the agreement reflect that aspect of the agreement, and retrospective changing of the rules reduces confidence in future agreements. In more general terms, carry-over provisions are consistent with encouraging nations to go beyond their commitments and to seek out least-cost outcomes.

With respect to the credits that Australia has generated from the first commitment period, the BCA's view is that they should be proportionately allocated between the cap for emissions covered by the clean energy package and the emissions that are not covered. Those allocated to the cap should be sold into the market and those outside the cap should be reserved for meeting the Kyoto 2 QELRO.

The BCA does not support the use of the credits to tighten the QELRO that Australia has entered into for Kyoto 2 as it is our understanding that the carry-over of these credits has already been factored into Australia's already challenging commitment – a commitment that the BCA is confident this review will find is more ambitious than the pledges nominated by almost all other advanced economies.

Global emissions budgets

As already stated, the BCA recommends that the CCA consider a range of credible global budgets associated with different levels of international commitment and ambition. This should be the key focus. Whether the CCA expands the matrix of budgets to include an 80% probability of outcome and different accounting of emissions is dependent on the resources available to the CCA, and should be considered secondary.

The BCA notes that Figure 6 ('Illustrative Alternate Global Emissions Trajectories for a Given Global Emissions Budget') presents two trajectories that are already irrelevant in terms of peaking of global emissions and the third, peaking in 2020, highly unlikely. The importance of the CCA analysing international action scenarios that produce credible global emission budgets cannot be emphasised enough.

International action

The BCA strongly agrees with the CCA's proposition that: "it is action that is paramount, not its legal form, nor where it is captured (for example, whether it appears in domestic legislation or a new international agreement)" (p. 18)

As was concluded in the Port Jackson Partners Limited report, the Australian targets need to take account of what other countries are actually doing, as distinct from any stated "political" aspirations that are not backed by concrete steps. In our view, there is no place for statements of intent, especially those made at a high political level.

Australia is a case in point. A carbon tax was first mooted by government in Australia in 1995 and an emissions trading scheme in 1999 and again in 2007 – the hybrid tax/trading scheme was not effected in legislation until 2012. Similar statements of intent can be traced back to the early 2000s in Japan, South Korea, Canada and the USA. What counts is action, not intent.

Assessing global action

The UNFCCC, the International Energy Agency (IEA) and the World Bank have all produced reports that have assessed the level of global action. All of these reports confirm that the level of action taken so far and the level of Cancun pledges fall well short of the global emissions budget necessary to meet the 2 degree Celsius aspiration. To be credible the review needs to assess other less ambitious scenarios.

In the BCA's view, the first task of the CCA would seem to be to assess whether the conditions exist to determine whether Australia should go beyond its -5% commitment.

The bipartisan Australian conditions (Box 3 of the issues paper) are that Australia will not increase its emissions reduction commitment below -5% until:

- the level of global ambition becomes sufficiently clear, including both the specific targets of advanced economies, and the verifiable emissions reduction actions of China and India
- the credibility of those commitments and actions is established, for example, by way of a robust global agreement or commitments to verifiable domestic action on the part of the major emitters including the United States, India and China
- there is clarity on the assumptions for emissions accounting and access to markets.

The details provided by Australia to the UNFCCC as part of the Copenhagen Accord in 2009 state:

> Australia will reduce its greenhouse gas (GHG) emissions by 25 per cent compared with 2000 levels by 2020 if the world agrees to an ambitious global deal capable of stabilizing levels of GHGs in the atmosphere at 450 ppm carbon dioxide equivalent (CO2eq) or lower. Australia will unconditionally reduce its emissions by 5 per cent compared with 2000 levels by 2020 and by up to 15 per cent by 2020 if there is a global agreement which falls short of securing atmospheric stabilization at 450 ppm CO2 eq under which major developing economies commit to substantially restraining their emissions and advanced economies take on commitments comparable to Australia's.[7]

The BCA contends that it is unambiguous that the results of the meetings of the Parties in Doha in December 2012 confirm that none of the three conditions in the issues paper or the criteria included in the Copenhagen Accord have been met. In particular:

- the specificity of the advanced economy targets and budgets as well as the transparency and independent verifiability of the possible actions that China and India may take, through to 2020 remain unfulfilled. Until these countries adopt QELROs or equivalent, to 2020 this condition will not be met
- as yet there is no 'robust global agreement' in prospect nor have there been independent institutional arrangements established that could credibly verify the domestic action of major emitters
- the assumptions countries have made to underpin their Cancun pledges remain unclear and may not be fully understood until after a post-2020 agreement is reached in 2015.

The second task is to assess the likely scope of coordinated global action beyond 2020. In this context, the submissions to, and outcomes of, the recently completed second meeting of the Ad Hoc Working Group on the Durban Platform for Enhanced Action are the best guide.

The BCA has not yet been briefed by the government on the outcomes of the meeting. However, it is clear from submissions that, while countries like Australia and the USA are prepared to put forward options for credible and flexible bottom-up ways forward to coordinated global action, the views of China and India remain rooted in the past 'developed' versus 'developing' country paradigm of a limited, inflexible and undeliverable Kyoto Protocol-style agreement.

In these circumstances, it will be difficult for the CCA to develop appropriate global emission budget scenarios to 2030 and 2050 that are robust enough to make recommendations on Australia's fair share.

In relation to Tables 2 and 3 in the issues paper, the BCA recognises that they are necessarily an incomplete snapshot of action. Nevertheless, they demonstrate the point that it is not possible at this stage to robustly quantify, in QELRO equivalents to Australia, the implications of the variety and level of pledges that have been made by other countries to 2020 and 2050.

Comparing targets across countries

The BCA notes the four metrics that the CCA proposes to use to compare the 2020 national pledges.

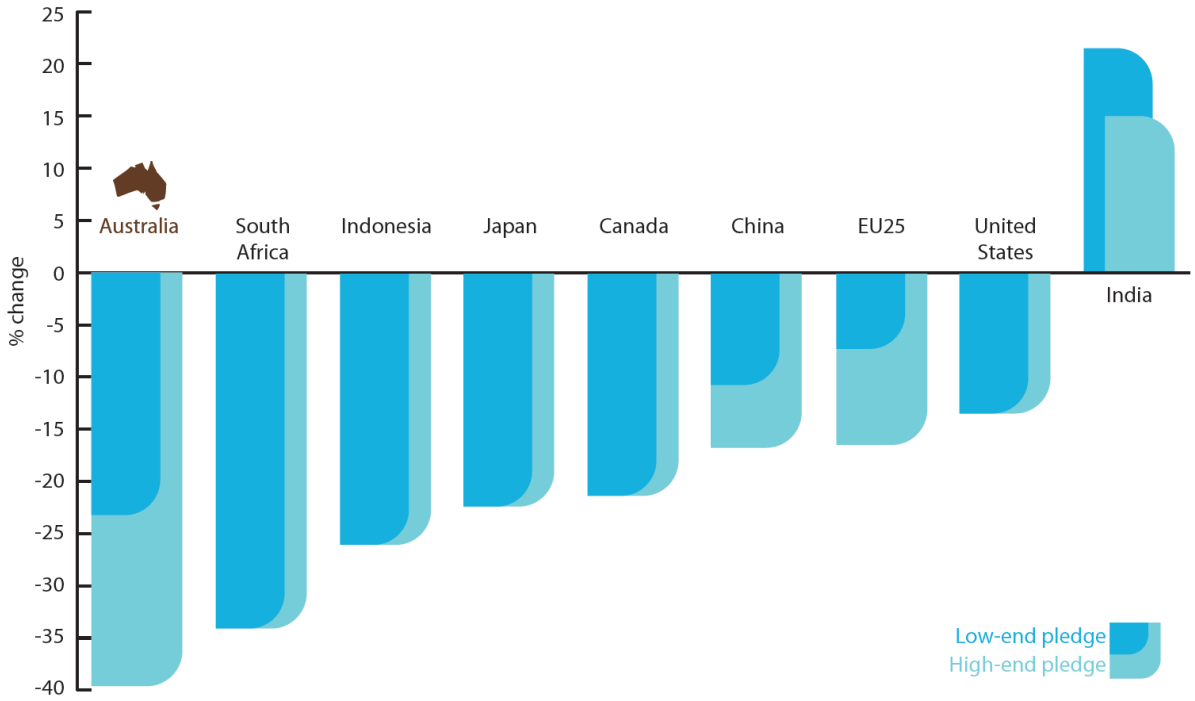
It is well known that metrics related to base years (absolute emissions, emissions intensity and per capita emissions) are unreliable measures of comparable effort. For example, the perception is that the USA's -17% by 2020 pledge using 2005 as the base year must be more ambitious than Australia's -5% by 2020 using 2000 as the base year. Yet if both pledges are reduced to a common year of say 1990, Australia's effort is -4% by 2020 and the USA effort is less at -3% by 2020.

[7] Compilation of economy-wide emission reduction targets to be implemented by Parties included in Annex I to the Convention ; see http://unfccc.int/resource/docs/2011/sb/eng/inf01r01.pdf

Of the four, the comparison to business-as-usual best reflects the level of comparable effort (see Exhibit 2), although not necessarily the level of comparable economic costs or burden, which ultimately drives the level of commitment countries can practically implement.

The BCA recommends the use of computable general equilibrium (CGE) modelling to complement these other metrics (see comments on modelling below).

Exhibit 2: Percentage change in emissions under Cancun pledges, relative to business-as-usual at 2020



Source: Department of Climate Change and Energy Efficiency.

Historically, Australia has compared its level of commitment, and achievement, to countries with similar economic wealth. These include the EU, USA, Japan and Canada. These countries remain relevant today; however, given the timeframe of the review to 2050, a comparison with the main 'advanced' countries, as defined by the government's commitments (for example, including China, South Korea, Brazil, Mexico and others), should also be made given their likely economic progress over the next 40 years. This broader approach is crucial to helping break the developed versus developing country paradigm that is holding back meaningful global agreement.

The use of CGE modelling to guide an assessment of Australia's comparable burden relative to that of other countries has long been central to Australia's negotiating position. It was relevant in 1997 when the Kyoto Protocol was signed and remains relevant today. Indeed, Australia made submissions in November 2008 and March 2009 to both the AWG-KP[8] and AWG-LCA,[9] titled respectively 'Australia's National Ambition' and 'Economic Cost as an Indicator for Comparable Effort',[10] underlining the importance of this approach to understanding comparable burden.

[8] Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP).
[9] Ad Hoc Working Group on Long-term Cooperative Action under the Convention (AWG-LCA).
[10] http://www.climatechange.gov.au/sites/climatechange/files/files/Economic-cost-comparable-effort-submission-AWG-KP-and-AWG-LCA.pdf

The BCA recommends that the CCA use comparable economic cost as the prime measure of comparable burden, as endorsed in the Australian submission:

> All developed countries should make mitigation commitments that represent a comparable effort, taking account of national circumstances, as part of the post-2012 outcome …
>
> It is important that indicators for comparable effort are robust, relevant, impartial and credible. Getting 'comparable effort' right will be crucial to the success of the post-2012 outcome, and is therefore critical to achieving the ultimate objective of the Convention to prevent dangerous anthropogenic interference with the climate system …
>
> One way to better reflect comparability of effort is to differentiate national emission reduction commitments according to relative economic costs. [11]

How Australian action can influence others

This is necessarily a very subjective topic prone to hubris at one extreme and contempt at the other. The BCA's advice is that both the urge to lead or to free-ride should be avoided by Australia.

The BCA's assessment of Australia's performance over the last two decades in the UNFCCC is that Australia's effective influence is no more or less than countries of equivalent standing, and that that effective influence was not materially altered by Australia's initial decision not the ratify the Kyoto Protocol, nor its subsequent decision to sign the Kyoto Protocol.

The BCA also notes that the decision by Australia in Doha to show leadership in declaring its QELRO to 2020 has not prompted other countries to follow suit.

No doubt the CCA will receive submissions that promote the promise of higher global ambition if Australia takes 'leadership'. The proposition appears to rely on the Garnaut report's assessment that, in benefit–cost terms, Australia has much greater economic returns than any other country from earlier and more ambitious global emission reductions.[12] This leads to the conclusion that Australians should be prepared to pay more than others for the same global environmental outcome.

The BCA disputes the robustness of the proposition and, therefore, its conclusion. The BCA contends that it is reasonable to assume that most, if not all, major emitters and advanced economies have undertaken similar analysis of the domestic economic, environmental and social consequences of not reaching the 2 degree Celsius aspiration. Given their political commitment to 2 degree Celsius under numerous UNFCCC decisions, it is incredible to accept that all these countries do not see benefits of similar magnitude to that of Australia.

What they do see, however, is very different costs that they might have to endure to secure those benefits. The BCA is yet to see a study of comparable economic costs that does not show the cost to Australia of its -5% commitment as among the very highest. Yet there is no evidence that this willingness to pay more on Australia's part has led to an increase in global action – any proposition to 'up the ante' further has no robust empirical rationale.

Sharing global emission budgets

The BCA appreciates that any discussion of how to share responsibility for future emissions reductions, or the allocation of future emission budgets, necessarily involves a mixture of different national perspectives and some academic theorising. However, there is no formula, other than that each nation will need to respect the pledges of others since the most likely outcome of a 2015 agreement is a continuation of national pledges of best endeavours.

Notwithstanding that nations may publicly justify their commitments in terms of some of the principles and approaches suggested in the issues paper, ultimately all nations will select their contribution to the global burden based on national self-interest. In a practical and domestic political sense in every nation, this boils down to 'willingness-to-pay'. In a comparative sense, the

[11] http://www.climatechange.gov.au/sites/climatechange/files/files/Economic-cost-comparable-effort-submission-AWG-KP-and-AWG-LCA.pdf

[12] Professor R Garnaut, *The Garnaut Climate Change Review Final Report,* September 2008, http://www.garnautreview.org.au/index.htm

BCA judges that Australians are willing to pay as much as Europeans, Americans, Canadians and Japanese, as measured by the impact on per capita GDP or GNI.

The BCA believes the lack of discussion on this aspect of the international negotiations is a significant shortcoming of the issues paper. Indeed, the principles in Box 5 and the approaches in Table 4 miss completely the main drivers of international negotiations over the last 20 years – namely, the relative economic burden of the national 'targets' and budgets, and in particular their trade implications.

The BCA notes that some of the principles and approaches are not conceptually consistent with the measurement of national emissions on a production basis. In particular, the notion of an individual right to emit and convergence of per capita emissions are concepts best suited to measuring emissions on the basis of consumption. The difference is stark – Australia is high on a production basis (about 27t/capita) but in the middle of the range of similarly affluent countries when measured on a consumption basis.[13]

It is also worth noting that the discussion about sharing budgets should emphasise that this is essentially a matter for negotiation between nations. How nations share their budget within their jurisdiction (including across generations) is not a matter for international negotiation.

Economic and social implications

In the context of this review, the key reason to undertake economic modelling is to assess the economic and social implications of different Australia commitments and budgets, relative to those pledged by other similarly wealthy countries – not in isolation or against some assumed coordinated action as was done by Treasury for the CPRS Bill and Clean Energy Act.

The modelling needs to take the global budget scenarios and allocate them in a way that delivers reasonably comparable economic costs on Australians, Europeans, Americans, Canadians and Japanese; lesser costs on for example South Koreans, Brazilians and Chinese until they reach economic wealth consistent with other Annex I countries; and very little costs on poorer nations.

That is, the outcome of the modelling would be to give some insight into what might be regarded as relatively comparable QELROs for the advanced and major emitting nations through to 2020, 2030 and 2050 under a range of credible global budgets.

Further, the modelling should include an assessment of the costs for Australia of trading versus not trading to reflect the differing policy positions of the government and the Coalition.

This is not to suggest that the modelling be used to determine what commitments Australia should accept from other nations. As has already been stated, each nation will need to respect the pledges of others. The modelling may, however, help inform Australia about one element of the negotiations that might encourage Australia to pledge more stringent QELROs for itself.

The approach being recommended by the BCA is in contrast to the approach being suggested by the CCA, whose approach concentrates on estimating domestic economic implications, rather than comparative international economic implications.

Under the BCA's approach it is recommended that, in addition to the Treasury model, the McKibbin model (G-Cubed) also be used as it specialises in international impacts. Further, in contrast to the previous Treasury modelling exercises, the BCA urges that all of the scenarios and assumptions, and the proposed outputs, be open to community scrutiny before the modelling is undertaken.

Setting caps

A key reason for the CCA to recommend budgets but not to recommend trajectories is the complexity the latter unnecessarily adds to the task of dividing Australia's international commitment between emissions covered by the trading scheme and those not covered.

There is of course no issue of setting caps if all emissions and sequestration are covered – a policy position advocated by the BCA.

[13] See for example the work of Glen Peters and Edgar Hertwich.

The economically efficient solution to setting the caps for the trading scheme in the circumstance of the scheme not covering all emissions is the one that is least-cost across the whole economy. However, this solution is unknowable – to know it requires government to have a full understanding of the costs of abatement and sequestration across all emissions and sectors in all time periods.

In these circumstances it is probable that the simplest solution is the best that can be achieved with the least unintended consequences.

The simplest approach is to divide the emissions budget between the covered and uncovered sectors based on the percentage of estimated business as usual emissions over the budget period. This approach shares the abatement task across the economy according to the expected level of emissions in the absence of all emissions policy measures. In this way the abatement task is spread equally between the covered and uncovered emissions, and while this is unlikely to be an accurate proxy for the distribution of abatement costs, it is at least representative of the structure of the economy.

The alternative approach is to load-up either the covered or the uncovered sectors of the economy with a disproportionate share of the abatement task. By definition, covered sectors will meet the cap of emissions that is allocated and this creates a temptation to load-up the covered sectors with more responsibility to meet the national budget. This is especially the case when it is unclear how governments intend to reduce emissions in the uncovered sectors.

However, to pass onto the covered sectors the risks and costs of failure to reduce emissions in the uncovered sectors would be a serious mistake. Further, to fund the emissions reductions of the uncovered sectors, or fund the purchase of equivalent emission offsets, from taxes collected on the covered sectors is also guaranteed to be an economically costly outcome, and inequitable to the workers and investors in those sectors.

All uncertainty, risk and costs associated with emissions in the uncovered sectors should reside with the government and not be transferred to covered sectors. In this respect, it is not necessary for the CCA to define policies that might be applied to the uncovered emissions and estimate the level of abatement that might be achieved. This approach to the task is highly speculative. The more sensible approach is simply to define the task that governments over time must take responsibility for in the uncovered sectors.

Similarly, while it may be that some sectors may become covered in the future, and this is clearly an appropriate solution to the problem, it is not the role of the CCA to speculate which will or will not be covered. This approach by the CCA would apply equally to the scenarios that would face a Coalition Government with a different set of policies – that is, it is not the task of the review to nominate the policies, but rather to recommend the appropriate task that Australia should shoulder relative to other nations under different global emission budget scenarios.

Where there is a legislated requirement for the CCA to set caps (for the first five years under the carbon price mechanism), this should be accompanied by a risk analysis considering the impact of setting caps too high or too low.

Progress toward medium and long-term targets

The BCA encourages analysis of how individual measures are performing and how other factors (e.g. exchange rates, economic growth rates, changes in relative prices, structural change, etc.) have influenced emissions abatement. This analysis will help define progress and identify the key drivers toward meeting Australia's QELRO commitment to 2020.

However, the BCA sees no need in this review for analysing the potential or expected performance of policies, measures and other factors looking forward. Further, the BCA sees no need to identify milestones other than national emissions and budgets that might be recommended to 2020, 2030 and 2050 under different credible international scenarios. Indeed, sectoral milestones are completely irrelevant to covered emissions in an emissions trading scheme.

The BCA recommends that the central task of this review should be to identify the range of potentially appropriate Australian international emission abatement commitments, and to assess the economic and social implications of those commitments.

It may be appropriate in a later review to assess whether current or proposed policy settings are sufficient to deliver the proposed emissions reductions in an economically efficient, environmentally effective and equitable way.

Attachment A: BCA Energy and Climate Change Policy Principles

Overarching principles

Energy policy should support Australia's future economic growth while recognising the need to transition the Australian economy to lower-emissions technology over the coming decades in line with international action on climate change.

Energy policy and the operation of the energy market should efficiently address current and future demand in a technologically neutral manner and ensure reliable and competitively priced energy that is developed in an environmentally responsible manner.

Energy policies should:

- ensure the development of energy resources in response to global and domestic market demand in a manner underpinned by streamlined, transparent and timely environmental, exploration, planning and project approval processes that are designed to support the development of the resource in an environmentally responsible manner
- ensure the development of an effective and efficient energy market where assets are primarily privately owned and can operate on a level playing field
- ensure energy prices are a function of an effective and open market and not functions of poor policy design or price regulation
- manage the risks associated with climate change in a manner that supports lowest-cost responses
- minimise regulatory burden ensuring a regulatory framework designed to deliver the most affordable electricity to the consumer with a level of reliability that accords with a consumer's willingness to pay
- support a positive long-term investment environment
- ensure technology neutrality and consideration of all possible energy technologies
- enable supply and demand-side participation and ensure that consumers are engaged and involved in markets, including through transparent and factual pricing and policy information
- ensure appropriate consumer protection measures are in place.

Within this framework, climate change policies should:

- ensure Australia acts as part of a global response that includes all major emitters of greenhouse gas emissions
- ensure Australia's emissions reduction commitments are premised on both Australia's contributions to global emissions and the possible impacts on Australia in the absence of global action
- contribute to a reduction in global greenhouse emissions relative to a business-as-usual outlook
- support market-based responses to enable lowest-cost outcomes
- include arrangements to fully offset the impacts on trade-exposed industries in the absence of policies in competitor countries placing equivalent costs on traded products
- facilitate the long-term and smooth transition of the electricity sector to lower-emissions technologies
- provide investment certainty to enterprises and investors

- support the research and development necessary to identify technology solutions – including low-emissions technologies
- support energy efficiency at the household and industry level
- build Australia's adaptation capabilities.

BUSINESS COUNCIL OF AUSTRALIA
42/120 Collins Street Melbourne 3000 T 03 8664 2664 F 03 8664 2666 **www.bca.com.au**