Business Council of Australia

Submission to the Climate Change Authority Review of the Renewable Energy Target

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About the BCA

The Business Council of Australia (BCA) brings together the chief executives of 100 of Australia's leading companies.

For almost 30 years, the BCA has provided a unique forum for some of Australia's most experienced corporate leaders to contribute to public policy reform that affects business and the community as a whole.

Our vision is for Australia to be the best place in the world in which to live, learn, work and do business.

Introduction

The BCA welcomes the opportunity to make a submission in responding to the issues paper released as part of the Renewable Energy Target (RET) Review.

BCA Energy Policy Principles

The BCA makes this submission from the perspective of a set of BCA energy policy principles. They are that energy policy should:

- ensure the development of an effective and efficient energy market where assets are primarily privately owned and can operate on a level playing field
- manage the risks associated with climate change in a manner that supports lowest-cost responses
- ensure electricity prices are a function of an effective and open market and not functions of poor policy design or price regulation
- minimise regulatory burden
- 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.

Context

The BCA submission is made in the following context.

All businesses and households are consumers of energy. Energy therefore fundamentally underpins the Australian economy.

Australia's economy has historically benefited from access to abundant and low-cost energy sources, notably arising from its substantial reserves of brown and black coal and natural gas.

Access to these sources of low-cost energy has provided Australian business in particular with a significant comparative advantage relative to its competitors.

Natural resource endowments have also provided Australia with considerable export opportunities. Indeed, 68 per cent of energy produced in Australia in 2008–09 was exported, while 32 per cent

was consumed domestically.[1] However, we are not alone in possessing abundant sources of energy.

The continuing development of emerging economies, in particular China and India, will lead to a greater demand for energy in the future. If we can remain competitive and productive in our energy markets, Australia's abundant natural resources will continue to present a considerable opportunity to capitalise on this increased global demand for energy.

Australia is, however, experiencing rapidly increasing electricity and gas prices, which has adverse impacts on household as well as business costs.

The contributors to these price increases are now well documented and include the RET, carbon price, increased network prices driven by the need to meet increasing reliability standards, to make up for historical underinvestment and to invest in new infrastructure necessary to meet increased demand, and in particular increased peak demand. The increasing requirement to accommodate renewable energy sources in the energy network has also necessitated extensions and upgrades. More recently the implementation of a price on greenhouse gas emissions has and will continue to have an impact on electricity prices and to a lesser extent gas prices.

For some time the BCA has argued that the introduction of a renewable energy target was not the best way to address the risks associated with climate change, as such a policy does not represent a lowest-cost approach to emissions reduction.

The policy has now been in place for several years and substantial investment decisions have been made on the basis of the policy. Such a situation makes it very difficult to address the adverse outcomes of the policy or accelerate the wind-up of the policy.

This review offers the opportunity to both consider the overall appropriateness of the RET and to subsequently consider the means available to minimise the costs associated with the policy.

The BCA acknowledges the diverse range of views with regard to the role and appropriateness of the RET. We are also conscious of the substantial investments that have been made or planned for given the existence of the RET. We also recognise that business is experiencing a range of policy changes in relation to energy, which means a less predictable policy environment and increased country risk making it difficult to confidently invest for the long term in the energy sector.

In responding to the review of the RET we have given consideration to the following issues:

- ensuring the development of an effective and efficient energy market
- managing the risks associated with climate change in a manner that supports lowest-cost responses
- ensuring electricity prices are not unduly increasing because of poor policy design
- supporting a positive investment environment.

Issues to consider

Ensuring the development of an effective and efficient energy market

As discussed above, Australia's economy has been based on access to relatively low cost and reliable energy supplies. The operation of a secure, effective and efficient energy market is a key contributor to this. The operation of such a market is largely dependent on:

- assets being primarily privately owned where private ownership drives greater competition
- prices that reflect costs ensuring that efficient investment is undertaken
- government policy and regulation that does not add unnecessary costs to the generation, distribution or retailing of electricity

[1] Department of Resources, Energy and Tourism, *Energy in Australia 2011*, 2011, p. 1.

- government policy that is technology neutral so as to ensure that technologies compete on a level playing field that allows for solutions to be arrived at in a least-cost manner
- demand and supply-side participation including informed consumers who are able to make choices as to their retailer and use of electricity
- appropriate consumer protection measures being in place.

The BCA pointed to the adverse impacts on the electricity market and prices that the RET would have, including inflating the costs of emissions reduction, inflating energy costs, subsidising technologies that may not be the most efficient contributors to the electricity market, and inflating business and household costs for no net additional environmental outcome.[2]

A number of more recent reports from the Productivity Commission and Independent Pricing and Regulatory Tribunal (IPART) point to the way in which policies such as the RET alter the operation of the electricity market with the end effect of reducing the efficiency of its operations as measured by inflated prices.

Technology neutrality in government decisions, particularly where direct funding is involved or being considered, is an important element of competitive markets. Technologies should be assessed on their economic merits, rather than on subjective views of their attractiveness. The government should not artificially restrict or reduce the viability of a given technology relative to other alternatives. Technology neutrality provides the best means of delivering solutions in a least-cost manner. Where technology choice is distorted it is likely to result in increased costs to end-users.

Government policies should aspire to be technology neutral. This allows the market to determine which technologies can deliver products and services in the most efficient manner, rather than government picking winners.

The introduction of legislation prescribing a level of renewable energy does not align with the principle of technology neutrality.

Managing the risks associated with climate change

The outcomes in Australia's electricity markets, including the price of electricity, in part reflect the suite of government policies in relation to climate change mitigation.

The BCA position continues to be that the introduction of a workable policy to establish a market-based mechanism to put a price on greenhouse gas emissions will lead to the lowest-cost emissions reduction. With the introduction of such an approach all other policies and programs with a stated objective to reduce greenhouse gas emissions, including through energy efficiency, should be wound up where possible unless there is evidence of some form of additional market failure.

While the BCA is disappointed the government did not include the necessary safeguards in the clean energy legislation, a price on greenhouse gas emissions has now been implemented. Still, there remain a large number of government policies that also have reducing greenhouse gas emissions as their primary objective. These policies should be concluded and the carbon price used to facilitate lowest-cost emissions reduction.

Many of these remaining policies, including the Renewable Energy Target, have a flow-on impact on electricity prices.

In putting forward our comments on the RET, we believe that a key consideration of the review should be whether or not the RET will assist Australia in achieving its emissions reduction target at the lowest cost.

[2] Business Council of Australia, *Modelling Success: Designing and ETS That Works*, 2008.

Ensuring electricity prices are not unduly increasing because of poor policy design

In previous submissions the BCA has highlighted that the RET will increase electricity prices and will not ensure lowest-cost emissions reduction.

Recent reports from the Australian Energy Market Commission (AEMC), Independent Pricing and Regulatory Tribunal and ACIL Tasman all point to the impact on electricity prices of the RET and other green policies.

IPART estimates that from 1 July 2012, the cost of complying with all green schemes will contribute around $316 on average to an indicative regulated electricity customer's bill in New South Wales.

While the BCA has not undertaken the analysis, one can assume the year-on-year impact of the RET on electricity prices since 2001 has been significant.

It should also be noted that consideration is now being given to increasing the capacity of the Victoria–South Australia transmission interconnection, in large part to address the substantial increase in renewables generation in South Australia. It has been suggested that the additional network costs could be in the vicinity of an additional $80 million.[3] Such investments are an additional hidden cost of the RET.

There are a range of federal and state policies that impact on the cost of the RET itself and should also be considered as part of any review of the RET. For example, federal and state planning and environmental approval processes bring additional project costs to the construction and deployment of renewable energy sources. Work currently underway through the Council of Australian Governments (COAG) to streamline approvals processes and to rationalise state and federal climate change and energy efficiency programs will be important contributors to reducing the costs associated with the RET.

The review of the RET should identify actions that can be taken to ameliorate the electricity price impacts of the RET.

Investment environment

Assessing and managing risk are key aspects of any business investment decision. Government actions that consistently change the rules of the game should be avoided unless they are strongly justified, as they make managing risk more difficult and add higher risk premiums to projects.

Considerable investments have already been made by businesses on the basis of the RET. Further investments are currently being planned and/or seeking approval. These investments would not have been commercial in the absence of the RET.

As a key principle, any amendments considered as part of the review should not adversely affect investments that have already been made and should be mindful of their impact on investments currently being planned or already seeking approval.

Consideration of the timing of future reviews should take into account both the benefits from reviewing the operation of the scheme and the negative effect on the investment environment that overly frequent reviews can create.

[3] ElectraNet Pty Ltd and the Australian Energy Market Operator Limited, *South Australia–Victoria (Heywood) Interconnector Upgrade: RIT-T: Project Specification Consultation Report*, October 2011, p. 11.

Reducing the impact of the RET on electricity prices

Taking the above considerations into account, the review of the RET should examine options explored below that are designed to reduce the upward pressure of the RET on electricity prices while recognising the investments already made as a result of the RET.

Continuation of the RET

The BCA has made clear its concerns with regard to the introduction of a renewable energy target. With substantial investments now made in light of the existence of the RET, the challenge is to ameliorate its impact while not adversely impacting on investments made and planned.

Under the current legislation the 20 per cent RET carries through to 2030.

It has been suggested that new targets should be set for the post-2020 period. Such a proposal should not be pursued. Instead it should be recognised that wider market forces, including a price on greenhouse gas emissions, will underpin energy investment choices.

Target level

The RET was designed to result in 20 per cent of Australia's electricity supply coming from renewable energy generation by 2020. The national electricity market (NEM) is designed to equate electricity supply with electricity demand. Given this, amendments to electricity demand forecasts have direct implications for the appropriateness of the target level.

Recent amendments to the electricity demand forecasts suggest that the RET, as currently defined, would result in around 26 per cent of Australia's electricity supply coming from renewable energy generation by 2020.

This substantial increase in the target imposes additional costs on electricity users going well beyond the initial policy intent.

Similarly, contrary to some proposals, the current circumstances should not be used as a basis for an increase in the RET target for 2020 or in the subsequent decade given the government's emissions trading scheme is now in place.

The BCA is of the view that the RET should be set at a level consistent with the policy objective that was set when the RET was amended – namely a target of 20 per cent.

A fixed MWh target equating to this target provides a clear signal of the level of investment required to meet it. The BCA supports the continuation of fixed MWh targets for the Large-Scale Renewable Energy Target (LRET).

Changes to the LRET 2020 target should only be considered where the current target is materially out of line with the stated policy objective. We recognise that a fixed target combined with an uncertain demand may not precisely deliver on the 20 per cent objective. However, the target should be set at a level that will deliver the stated objective, or as close to it as possible.

We believe that the current level of the target is **materially** out of line with the stated objective of the policy mechanism. What is required is a return to the 20 per cent target based on current AEMO demand forecasts not the forecasts that applied at the commencement of the RET.

As such, either a one-off adjustment or a one-off levelling off of the current trajectory should be considered, with such an adjustment implemented in a manner that does not adversely impact on investment decisions already made, and should be mindful of their impact on investments currently being planned or already seeking approval.

Small-Scale Renewable Energy Scheme

The uncapped nature of the Small-Scale Renewable Energy Scheme (SRES), combined with other government policies such as feed-in tariffs, has resulted in a large number of small-scale technology certificates (SRECs) being created. Furthermore, the greater than expected number of SRECs has not been accompanied by a commensurate reduction in the LRET. Indeed, the SRES is currently more expensive than the LRET, and may continue to be for the next few years.

The level of the LRET has been set based on previously assumed electricity demand forecasts, as well as assumptions about the level of take-up of the SRES. The uncapped and uncertain nature of the SRES adds another variable in terms of the overall components of the RET delivering on the stated objectives of the overall policy.

Consideration should be given to reducing the unintended impacts of the uncapped SRES. One option would be to continue to reduce the multiplier being used. Another would be to do away with the split between the SRES and the LRET, especially as the technology costs associated with small-scale renewables have dropped substantially, largely offsetting one of the grounds for the split in the first place.

In considering changes to the SRES, more detailed modelling of their relationship with the overall target and their impact on the investment environment may be required.

Treatment of trade-exposed industries

Under the current RET arrangements, some trade-exposed industries are eligible for a partial exemption from the cost impost of the RET to assist these industries in maintaining their competitiveness. Similarly, some-trade exposed businesses can access the self-generator exemption.

Both these arrangements under the RET remain essential and as part of the RET review there should be changes made to ensure the full competitiveness impact for all trade-exposed industries is addressed.

In particular, the partial exemption arrangements should cover the full impact of the RET, not as is the case currently, just the volumes and prices above those that applied in the previous mandatory renewable energy target.

Frequency of reviews

Under the current legislative arrangements there is a requirement for a review of the RET every two years. There is a risk that the frequency and short time periods between reviews will of themselves have an adverse impact on longer-term investment in energy infrastructure.

One way to address this is to identify now the nature of the future reviews making clear what the specific role of the review will be and matters to be considered. The BCA proposes the use of a “light touch” approach for most reviews and then specified years for matters such as the process for phasing out the RET at the end of the current legislated period (2030).

Clean Energy Finance Corporation

In previous submissions the BCA has highlighted its concerns with regard to the establishment and operation of the Clean Energy Finance Corporation (CEFC). The CEFC legislation prescribes that $2 billion in funding will be provided to the CEFC each year, for five years, from 1 July 2013.

Embedding the funding in the legislation removed the usual budgetary discretion available to consider, or reconsider, funding allocations. CEFC investments are to be split between a renewable energy stream, which must represent more than 50 per cent of their investment, and a low-emissions/energy efficiency stream which can represent up to 50 per cent of their investment.

The carbon price itself, and its effect on the relative competitiveness of various competing technologies, should be the key determinant of our future energy mix.

The CEFC is not technology neutral and is also directed at projects that are likely to be less economic than available alternatives. This will distort market outcomes and increase the overall cost of reducing greenhouse gas emissions. The CEFC also fills a role already adequately covered by banks and other financial institutions and places the government in the undesirable position of being a potential lender of last resort.

It has been suggested that the LRET target be increased in response to CEFC investments. Such a proposal brings substantial uncertainty given the difficulties in anticipating CEFC funding decisions. It should be recognised that this will lead to a further impost on households and business.

The RET should not be adjusted on the basis of CEFC funding decisions. More broadly, this review of the RET should consider the possible adverse impact of the CEFC on the operation of the national energy market and on private sector investment in the energy sector.

Please contact Maria Tarrant, Deputy Chief Executive, Business Council of Australia, on 03 8864 2664 with any queries related to this submission

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