



Submission:

**Senate Inquiry into the
Government's Direct Action Plan
January 2014**

by the

Sustainable Energy Association of Australia

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Introduction

The Sustainable Energy Association of Australia (SEA) is a peak business body for the sustainable energy industry and for enterprises supporting sustainable energy. We count nearly 300 businesses across Australia as members, all of whom are united by a common interest in renewable energy, energy efficiency, and sustainable energy products and services. Our members represent all aspects of the supply chain, from small renewable operators through to large industrial users.

SEA's vision is to **accelerate the transition to the new sustainable energy economy**. SEA believes that we need to change our energy habits for the Australian economy to remain competitive and prosper, to prevent the destruction of our environment, and to reduce risk and provide hope for future generations.

SEA supports a 5% target for emissions reduction and believes that it is possible to reduce emissions further, which would position Australia as a leader in emissions reduction while maintaining a growing and sustainable economy.

SEA welcomes the opportunity to submit its views on behalf of our members to the Senate inquiry into the Government's Direct Action Plan.

Our Understanding of Direct Action

The Direct Action plan objective to reduce greenhouse gas (GHG) emissions relies on the removal of atmospheric CO₂ through "...soil carbons ... supported by other practical measures that will reduce CO₂ emissions"¹. The Direct Action plan claims that this strategy "... is also the lowest cost CO₂ emissions reduction available in Australia on a large scale."² Direct Action has a target of reducing emissions by 85 million tCO₂-e in 2020 and this constitutes 60% of the necessary reductions required.³

The Direct Action plan identifies a range of possible GHG abatement sources, but there is little available detail as to how many of the components of the Direct Action plan will work. The key elements, as released by the LNP Coalition prior to the election include:

- 1) The Emissions Reduction Fund (ERF) providing funding of \$3 billion over four years;
- 2) The 'Green Army' to carry out projects such as re-vegetating sand dunes, cleaning up riverbanks, weed control and regenerating local parks;
- 3) A rebate for the installation of solar power and solar hot water heating systems;
- 4) Grants for towns and non-capital cities to access direct solar energy for on-site energy use and return of excess power to the grid;
- 5) Allowing schools to access major solar energy projects for on-site energy use and return of excess to the grid;
- 6) Grants for towns and non-capital cities to establish micro, pilot and demonstration geothermal and tidal energy projects;
- 7) \$60 million to develop the La Trobe Valley, Hunter and Central Queensland regions as hubs for clean energy research and development;
- 8) The reservation of up to 6,000GWh by 2020 within the Renewable Energy Target scheme ("RET") for 50+ MW renewable energy projects and above 10+ MW emerging renewable energy projects; and

¹ <http://www.greghunt.com.au/Issues/DirectAction/DirectAction-Index.aspx>

² <http://www.australianfederalelection2013.com.au/will-the-oppositionrsquos-direct-action-plan-work.html>

³ Edis, T (2013) *Direct Action to Abbott's Gospel Truth*, Climate Spectator, 24 April 2012

9) The planting of 20 million trees in available public spaces.^{4 5}

Of these only 1) and 2) have any details released to date regarding policy and implementation detail.

SEA Perspective on Direct Action

In light of the views and feedback received from its members and research into the LNP Government's Direct Action plan, SEA does not believe that Direct Action, as it is currently outlined, is sufficient for Australia to meet its goal of a 5% reduction in GHG emissions by 2020.

SEA has several key concerns with Direct Action as currently outlined. We believe:

- The Direct Action plan is not the best policy option to reduce GHG emissions as it fails to provide a market-based price signal to reduce emissions;
- There is a real risk that Direct Action will not achieve Australia's emissions reduction targets;
- Aspects of Direct Action, including the baseline-and-credit system, the setting of emission baselines, consideration of additionality, and scheme compliance, have not been adequately detailed and may be ineffective; and
- The cap on funding and the short time horizons within Direct Action create continued policy uncertainty, which will hinder investment.

The reasons for our position are set out in this submission.

⁴ Allens (2013) *Focus: The Opposition's Direct Action Plan* <http://www.allens.com.au/pubs/cc/focc23apr13.htm>

⁵ Energetics (2013) *The Coalition's Direct Action plan: an overview* http://www.energetics.com.au/getmedia/45d0b04e-53c4-4b33-af6b-35e8f54a39ab/Direct-Action-Handout_An-overview_-part-1.pdf.aspx

Direct Action v. Alternative Methods for GHG Reduction

SEA favours a broad-based solution that allows the market to determine the long-term price of GHG emissions. Our concerns with the Direct Action plan are that it amounts to a subsidy, is overly interventionist, and fails to apply a market-based price signal to reduce emissions.

SEA agrees with the majority view of economists that Direct Action is a less-than-optimum solution to the issue of addressing climate change. A recent poll on the best mechanism of addressing emissions reductions:

*"...shows there is near-unanimity among economists that a market-based solution, such as a carbon tax or an emissions trading scheme, is the best policy option to reduce carbon pollution. This echoes similar surveys taken in past years."*⁶

Under Direct Action, neither businesses nor the community will receive signals or incentives to change their decisions on how to act to reduce GHG emissions.

We acknowledge that the Government claims that Direct Action is market-based and that the Government supports the principle of market-based mechanisms. However, the Government does not agree with the emissions trading scheme as set out by the Clean Energy Future package, with Minister Hunt saying, *"We disagree, absolutely, on what is the right market mechanism."*⁷ This places the Government at odds with the majority of expert economic opinion in this area.

Furthermore, SEA agrees with the premise that with Direct Action, the Government:

*"... is confounding pro-market policies with pro-business policies. Pro-market policies are about using market pressures to enlarge our economic pie; pro-business policies are about grabbing a bigger slice of that pie for friends in the business community."*⁸

SEA and its members support the retention of a market price on carbon administered and traded through an emissions trading scheme and does not support the current effort to repeal the Clean Energy Future package and associated programs.

⁶ Wade, M (2013) *Economists remain convinced carbon tax or ETS is the way forward*, Sydney Morning Herald [Online] <http://www.smh.com.au/federal-politics/political-opinion/economists-remain-convinced-carbon-tax-or-ets-is-the-way-forward-20131027-2w9rv.html>

⁷ Hunt, G (2013) *The Coalition Government's plan to tackle climate change, reduce emissions and reduce pressure on electricity prices* <http://www.environment.gov.au/minister/hunt/2013/sp20131024.html>

⁸ Wade, M (2013)

Direct Action's Capacity to Deliver Cost-Effective Reductions

Australia has committed to reduce its GHG emissions 5% below 2000 levels by 2020.

According to the recent report *Australia's Abatement Task and 2013 Emissions Projections*⁹, this will require us to reduce emissions by 431 million tCO₂-e (based on the expected growth of emissions over the period to 2020). Based on current projections, the reduction for the year 2020 alone is 131 million tCO₂-e. However, more specific annual reduction targets to meet the 2020 target are not detailed within the report, only the 2020 target.

Overreliance on Soil Carbon

Based on statements of Direct Action's objectives, the plan will rely heavily on soil carbon sequestration to reduce net emissions. However, independent analysis indicates that it is highly unlikely that sequestration through soil carbon will achieve the targets the plan has outlined. For example, review by the CSIRO indicates reliance on soil carbon sequestration holds significant uncertainties:

*"... the total potential of agricultural soils to store additional carbon, the rate at which soils can accumulate carbon, the permanence of this sink, and how best to monitor changes in SOC stocks."*¹⁰

A report by a group led by Professor Rick Roush of the University of Melbourne concludes that:

*"...the potential of ... improved practices to store C [carbon] is limited to the surface 0–10 cm of soil and diminishes with time. None of these widely adopted practices is currently financially attractive under Australia's new legislation known as the Carbon Farming Initiative."*¹¹

The implication of this report is that soil carbon storage projects made little difference, and then only for 10 years, after which the benefits 'wear off.' Comments by Professor Roush indicated that Direct Action *"...would result in only 53.3 million tonnes of CO₂ equivalent sequestered in soil and would therefore not meet the 85 million tonnes targeted."*¹²

The price paid for this abatement is also a significant issue. Analysis of the economic impact of these activities demonstrates that the cost to farmers of undertaking such sequestration, either under the Carbon Farming Initiative (CFI) or under Direct Action, is likely to exceed the cost of carbon paid by the market or the Government. For example, under CFI with a \$24.15 /t CO₂-e price, on average farmers would lose \$12 / t CO₂-e. As Direct Action aims to reduce net emissions at the lowest cost, based on the economic analysis of carbon sequestration, it is likely that other abatement methods will be more likely to achieve GHG reductions at a lower cost.

⁹ Department of the Environment (2013) *Australia's Abatement Task and 2013 Emissions Projections*,

¹⁰ Sanderson, J, Farquharson, R. & Baldcock, J (2010) *Soil Carbon Sequestration Potential: A review for Australian agriculture*, CSIRO, http://www.csiro.au/~media/CSIROau/Flagships/Sustainable-Agriculture-Flagship/SoilCarbonSequestrationPotential_SAF_PDF%20Standard.pdf

¹¹ Shu Kee Lam, Deli Chen, Arvin R. Mosier & Richard Roush (2013) The potential for carbon sequestration in Australian agricultural soils is technically and economically limited, *Scientific Reports* 3, Article number: 2179, doi:10.1038/srep02179; <http://www.nature.com/srep/2013/130710/srep02179/full/srep02179.html>

¹² Hannam, P. (2013) *Coalition's soil carbon plan 'unviable', study finds*, Sydney Morning Herald [Online]; <http://www.smh.com.au/environment/climate-change/coalitions-soil-carbon-plan-unviable-study-finds-20130717-2q3e3.html>

Achieving Cost-Effective Emissions Reduction

To achieve abatement of 431 million t CO₂-e by 2020 with a budget of \$1.55 billion, as is currently proposed, the average price of carbon would need to be \$3.60/t CO₂-e to achieve the emissions target. This price is below the current EU carbon price of €5.15 (\$7.94 at time of writing). United Nations-sourced Certified Emission Reductions are trading at far lower cost (€0.35 /\$0.54), but neither of these will be eligible under Direct Action for sourcing emissions reductions.

Targeting a benchmark price for GHG abatement as the sole determinant of meeting emissions reductions targets is economically conservative. However it does not recognise other net benefits to the economy generated by GHG abatement technologies and activities. For example, increasing adoption of renewable energy in Australia has reduced wholesale energy prices and contributed to reducing network demand. Both of these should apply negative pressure on electricity prices, leading to lower business and residential costs.

Our research has found no independent analysis that identifies the current comparative pricing of GHG abatement technologies and the opportunities for abatement on an economy wide basis, for example as seen with McKinsey cost abatement curves.¹³ The changes to both the availability and cost of technologies, as well as economic changes, have rendered existing cost curves out of date to some degree for both the cost and capacity of a range of abatement options.

We believe it is irresponsible to 'pick a winner' (e.g. soil carbon) as a solution for a national abatement strategy without consideration of changes in the cost of technologies and their potential impact. This is particularly relevant in light of the reduction in costs of many renewable energy options.

Interestingly, the McKinsey GHG abatement cost curve for Australia identifies afforestation and agriculture (soil carbon) as the 6th most expensive option for economy-wide GHG reduction. A more recent version of the abatement cost curve by ClimateWorks shows a lower cost reduction through improved land use¹⁴ but this data implies a predominant positive impact on GHG emissions would be achieved through afforestation rather than increased soil carbon.

Independent reviews of Direct Action have also cast doubt upon its ability to achieve our emissions reductions targets, particularly through the land sector. A report by Bloomberg New Energy Finance noted that:

"... the government's Direct Action policy will not be effective, and is largely an exercise in wishful thinking"; and

"It is very hard to see how projects will be viable under this mechanism, particularly ones that will be big enough to provide the amount of abatement the government requires. All of the

¹³ McKinsey & Co (2008) An Australian Cost Curve for Greenhouse Gas Reduction; http://www.mckinsey.com/~media/McKinsey/dotcom/client_service/Sustainability/cost%20curve%20PDFs/Australian_Cost_Curve_for_GHG_Reduction.ashx

¹⁴ ClimateWorks (2011) Low Carbon Growth Plan for Australia , via www.climateworksaustralia.org/sites/default/files/documents/publications/climateworks_lcgp_impact_of_the_carbon_price_package_revised_edition_aug2011.pdf

bankers we have surveyed have said projects under the scheme will be practically unfinanceable.”¹⁵

Modelling by SKM-MMA and Monash University's Centre of Policy Studies, conducted on behalf of the Climate Institute, noted that a further \$4 billion of budget expenditure would be required to hit the minimum emissions reduction target of 5%.¹⁶

This report has been dismissed by the Government, which has refuted it on political grounds.¹⁷ Effectively this report states that should the Coalition pursue Direct Action, without any future potential to increase to spending on activities related to it, then Direct Action will not achieve the 5% target.

Information released by the Coalition on Direct Action at this time does not contain credible arguments that refute the veracity of the modelling provided by the report. As stated by the Prime Minister, the budget for Direct Action is capped – it will not be increased regardless of whether the 5% emissions reduction target can be reached. This sets up a concern – if Direct Action fails to achieve the emissions reductions targets under the allotted budget, which will be sacrificed – the budget, or the target?

International Credits

As noted, with the introduction of Direct Action (in lieu of direct pricing of carbon in a cap and trade mechanism), there are significant concerns as to whether Australia will meet its 5% commitment by 2020. This concern is exacerbated by the requirement under Direct Action that all emissions reductions must be sourced domestically – no use of overseas emissions credits will be allowed.

As detailed in this submission, SEA's concern is that the mechanisms to achieve domestic emissions reductions under Direct Action are not sufficient to meet our emissions reduction commitments. Therefore it is likely that additional future reductions will be required, at a higher cost to the Australian economy.

SEA is concerned by the opinions of independent sources as the ability of Direct Action to meet Australia's emissions reduction commitments, and based on these views, does not believe Direct Action is in the best interests of the nation.

¹⁵ Bloomberg New Energy Finance cited in Parkinson, G. (2014) *Direct Action trashed as "wishful thinking" and unfinanceable*, RenewEconomy [online] <http://reneweconomy.com.au/2014/direct-action-trashed-as-wishful-thinking-and-unfinanceable-69946>

¹⁶ SKM (2013) *A Review of Subsidy and Carbon Price Approaches to Greenhouse Gas Emission Reduction*, Climate Institute, http://www.climateinstitute.org.au/verve/_resources/SKM_ReviewofSubsidyandCarbonPriceApproaches_August2013.pdf

¹⁷ Butler, M. (2013) *How much will the Coalition's Direct Action plan cost?* <http://www.politifact.com.au/truth-o-meter/statements/2013/aug/20/mark-butler/how-much-direct-action-cost/>

Measuring Abatement under Direct Action

SEA supports the reduction of GHG emissions and the measurement of these reductions using the National Greenhouse and Energy Reporting Scheme (NGERS). The NGERS scheme is a model familiar to both consultants and businesses that provides an independent methodology for accounting for emissions reductions. Continuing to use NGERS to measure emissions reductions will minimise the cost of verification for businesses.

Measurement of abatement activities under Direct Action will be conducted at either (or both) a 'facility' or a 'project' level.¹⁸ In both of these methods, a 'baseline and credit' method will be used, except where the business is a new market entrant or is undertaking a 'major' expansion (we note that the definition of these circumstances has yet to be detailed). A 'baseline and credit' system is in many ways flawed and presents problems that are not present to the same degree in a broad-based price on carbon. The former Department of Climate Change and Energy Efficiency noted some of the problems with a baseline and credit system, including:

- **Uncertainty over final carbon pollution levels:** a target under a baseline-and-credit scheme is normally defined as the number of tonnes of abatement that must be secured in each year.
- **Difficulty in defining 'real' abatement:** because abatement is credited against a hypothetical estimate of what the level of carbon pollution would otherwise have been, it is difficult to be sure that abatement credited represents a real reduction in carbon pollution.
- **Administrative complexity:** all abatement must be defined in scheme rules before it can be rewarded. There is no automatic incentive to reduce carbon pollution.
- **Need to regularly update baselines:** baselines can become out of date, which increases the chances of crediting abatement that is not 'real.' To avoid this, baselines can be updated at regular intervals, increasing administrative costs and potentially reducing business certainty.
- **No source of revenue to provide transitional assistance:** a baseline and credit scheme raises no revenue and comes at a net cost to the Budget.¹⁹

Setting Baselines – More Detail Required

The Government has said it will defer its decision on how emissions baselines will be determined until mid-2015. This is a critically important element of Direct Action that remains uncertain and will affect the types of emissions reduction activities that take place.

For example, a baseline and credit system that averages out individual entities' historic emissions performance may disadvantage businesses or facilities that have already taken action to reduce their GHG emissions. That is, entities that have taken no action on GHG emissions reductions have more opportunities to access subsidies than those who have already acted to reduce emissions.

This raises significant issues as to the equality in markets. It is SEA's view that such Government intervention acts to significantly disadvantage fast movers in the market against slower moving competitors.

¹⁸ Emissions Reduction Fund – Green Paper <http://www.environment.gov.au/topics/cleaner-environment/clean-air/emissions-reduction-fund/green-paper>

¹⁹ DCCEE (?) *Baseline-And-Credit Scheme*; <http://climatechange.gov.au/sites/climatechange/files/files/reducing-carbon/mpccc/baseline-credit-scheme-pdf.pdf>

Insufficient Consideration of Additionality

The 'additionality' of reductions in GHG emissions achieved under Direct Action is insufficiently addressed by the plan, particularly within the structure of the Emissions Reduction Fund. The ERF does not detail adequate safeguards to ensure emissions reductions are 'additional' to reductions that would have happened without intervention. As currently structured, SEA has a concern that emissions reductions activities that are already planned and viable (and therefore not additional) have a distinct advantage under the 'reverse auction' aspect of the ERF.

Small Carrots, No Stick

In addition to the abovementioned problems, the lack of penalty for non-compliance²⁰ indicates that the Direct Action plan creates little or no incentive for entities to invest in low emissions technologies and behaviours. It would appear that non-compliant entities would suffer few if any financial consequences, which calls into question overall compliance with Direct Action commitments.

²⁰ Lloyd, G. (2014) *No penalty for carbon polluters*, The Australian, <http://www.theaustralian.com.au/national-affairs/policy/no-penalty-for-carbon-polluters/story-e6frg6xf-1226796174066#>

Continued Policy Uncertainty Harms Investment

SEA has consistently argued that regulatory and policy certainty is the key to long-term, committed and sustainable action on GHG reduction by businesses and markets. The five-year time horizon under Direct Action (other than for land based emissions reductions) is, in many cases, seen as too short a period for either investment certainty or the ability to finance a project.

Furthermore, the Direct Action plan is only funded for a three-year period initially. This creates a significant concern that it will create a boom-bust cycle of regulatory and political uncertainty, one that has been historically problematic for both renewable energy and energy efficiency markets and businesses. Short-term policy, such as Direct Action as it is currently framed, is opportunistic rather than visionary and is not likely to contribute to the development of technology, knowledge and skills within Australia to support the long-term reduction of Australia's carbon emissions.

Short-term policies in this area have the genuine potential to be more of a disruptive force than a benefit to both businesses and the economy in the longer term. This regulatory uncertainty is one of, if not the, major contributor to the lack of development and commercialisation of renewable energy and energy efficiency technologies in Australia.

Clean Energy Finance Corporation

With the intent to abolish the Clean Energy Finance Corporation (CEFC), SEA believes that there will be a significant 'hole' in the potential for new renewable energy and energy efficiency projects within Australia that can be achieved on commercial terms. Traditionally, Australian investment in these areas has been difficult and a lack of positive policy signals from government has exacerbated this problem.

The CEFC has gone a long way toward supporting intelligent and commercially viable development and initiatives in renewable energy and energy efficiency with a commercial return to investors. Retaining the CEFC will have a continued positive impact on renewable energy and energy efficiency businesses in Australia, providing a cost-effective way to help meet our carbon emissions reduction targets.

Sustainable Energy Association of Australia

SEA is a chamber of businesses variously promoting, developing and/or adopting sustainable energy technologies and services that minimise the use of energy through sustainable energy practices and maximise the use of energy from sustainable sources.

SEA builds relationships with businesses that aspire to be more sustainable in their own energy use, are providing the commercial solution to climate change through their products and services, or indirectly through their actions adopting more sustainable energy practices in their own business. By joining SEA, our members are acting to support the development of the best policy outcomes for the industry.

The role of governments is to build frameworks of governance that establish clear market signals for change and growth, and allow Australia's innovative businesses to respond and deliver market-based solutions. A key role of SEA is to offer policy options to governments building those frameworks.

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