



**AUSTRALIAN  
CONSERVATION  
FOUNDATION**

January 17, 2014

The Australian Senate  
Standing Committee on Environment and Communications  
Parliament House  
Canberra ACT 2600

Dear Ms McDonald,

**Re: Inquiry into the Government's Direct Action Plan**

**Summary**

ACF's view is that the Direct Action Plan, as currently proposed, an incomplete and ineffective greenhouse gas pollution reduction policy that will lock in long-term uncertainty about climate policy. To avoid increasingly costly long term climate damage Australia must adopt strong domestic legal targets, in concert with encouraging appropriate action by other countries.

**ACF recommendations**

1. Climate policy must be designed to achieve pollution reduction targets over the long term (beyond 2020), in line with the environmental, social and economic risks that climate change presents.
2. Climate policy must ensure Australia can meet its international commitments.
3. ACF recommends pollution reduction targets of 40% below 1990 levels by 2020, 60% by 2030, with net zero pollution achieved by 2050.
4. The Direct Action Plan policy suite (DAP) has a useful role to play as a part of a more comprehensive climate policy structured around stronger targets and long term, legal and enforceable pollution reduction. The Emissions Reduction Fund (ERF) could complement:
  - An emissions trading scheme or baseline-and-credit scheme, possessing science based appropriate long term pollution caps, with coverage over most of the economy;

- Sector specific greenhouse gas abatement regulation.<sup>1</sup>
- 5. As an element of the ERF white paper process, the Productivity Commission should be commissioned to review the ability of the ERF/DAP and other policy tools to drive achieve long term pollution reduction. This review must consider the capacity of the scheme to deliver pollution reduction in line with Australia's international pollution reduction commitments, both over the period 2014-2020, to 2030, and to 2050.
- 6. The Climate Change Authority must be retained, with a mandate to monitor Australia's performance against decarbonisation targets, and with updating and refining Australia's approach to meeting those targets by reference to developments in climate science and changes in context caused by changes in the scale or speed of global action.

### **ACF comments**

- (i) The environmental case for reducing Australia's production of GHG pollution is compelling.
- (ii) The DAP will not drive long term structural decarbonisation of the Australian economy, and the DAP's existing pollution reduction targets are far too low. Climate change will not end in 2020 and business decisions being taken now and up to 2020 will have costly impacts for decades for come.
- (iii) The DAP fails to honour Australia's existing international pollution reduction goals.
- (iv) ACF is not aware of any independent modelling that suggests the existing and inadequate pollution reduction targets will be achieved under the DAP, given current funding commitments. Additionally, modelling suggests that the costs of the scheme will become unsustainable if it is scaled up to achieve evidence based decarbonisation objectives indexed to Australia's existing decarbonisation commitments (that is: action in line with a two degree decarbonisation target).
- (v) Prior experiences with policies possessing similar structure show they fail to deliver low-cost pollution reduction.
- (vi) The ineffectiveness of the DAP policy suite (low ambition, poor scalability) will only serve to lock in policy uncertainty, leading to poor outcomes both for business and the environment. Problems specific to the scheme's architecture flow from (amongst other things) complexities of baseline settings, inequities, problems with baseline compliance mechanisms and monitoring, and inequities and perverse incentives to pollute.

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<sup>1</sup> An example of decarbonisation through strong sector specific regulation are the moves President Barack Obama has recently signaled in the United States. The two most important elements of these regulations are those aimed at reducing the emissions intensity of electricity generation by imposing pollution limits, and those that mandate fuel economy standards for Model Year 2014-2018 heavy-duty trucks, buses, and vans.

## **The environmental case for action to reduce Australian GHG pollution is compelling**

ACF urges the Federal government to adopt GHG mitigation policies consistent with minimising the destructive impact of climate change on our ecological life-support systems, and on the natural world. Current GHG pollution trajectories (inclusive of existing international pollution reduction commitments), place the planet on track for mean global surface air temperatures rise of 4°C by 2100.<sup>2</sup> Anticipated warming will exceed the adaptive capacity of land, freshwater, and coastal Australian environments, leading to catastrophic environmental outcomes for Australia, including the loss of approximately 40% of Australia's terrestrial species,<sup>3</sup> large-scale alterations in rainfall patterns on which iconic terrestrial ecosystems (and agriculturalists) depend,<sup>4</sup> ocean ecosystems affected by rapid increases in acidification, as well as increases in temperature leading (e.g) to bleaching incidents triggered by ocean heatwaves, movements in species ranges, and the extinction of some species.<sup>5</sup> Such changes will also impact on Australian communities, with changes in rainfall threatening agricultural communities in South-West WA and the Murray-Darling Basin, while coastal communities will be increasingly threatened by tidal surges, and most Australian communities will be more likely to be affected by greater numbers of heat waves.<sup>6</sup>

These impacts can be reduced by prompt global action to slow and eventually reverse climate change. Australia is a major contributor to climate change, generating c.2% of global GHG and possessing the second highest per capita GHG production amongst 32 OECD nations.<sup>7</sup>

**ACF strongly recommends that an independent body should be retained to provide oversight on the performance and adequacy of Australian climate policy. For this reason, ACF supports retention of the Climate Change Authority.**

Australian climate policy has been politicised in recent years, leading to poor environmental outcomes, while policy instability has also undermined investor confidence. The quality of Australian climate policy benefits from the existence of the Climate Change Authority, an independent agency tasked with monitoring Australia's performance against decarbonisation targets, and with updating and refining Australia's approach to meeting

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<sup>2</sup> See the World Bank's 2012 'Turn Down the Heat' report, at [http://climatechange.worldbank.org/sites/default/files/Turn\\_Down\\_the\\_heat\\_Why\\_a\\_4\\_degree\\_centrigrade\\_warmer\\_world\\_must\\_be\\_avoided.pdf](http://climatechange.worldbank.org/sites/default/files/Turn_Down_the_heat_Why_a_4_degree_centrigrade_warmer_world_must_be_avoided.pdf); IPCC's 2013 'Climate Change 2013: the Physical Science Basis', at <http://www.ipcc.ch/report/ar5/wg1/#.UomVEcRpk0>. Both accessed November 15, 2013.

<sup>3</sup> See Lesley Hughes, 'Changes to Australian terrestrial biodiversity', in Christoff (ed) *Four Degrees of Global Warming*, pub: Earthscan, Melbourne, 2013

<sup>4</sup> See Howden *et als* 'Agricultural in an even more sunburnt country', in Christoff (ed) *ibid*.

<sup>5</sup> See 'Hoegh-Guldberg *et als* 'Australia's marine resources in a warm, acid ocean', in Christoff (ed) *ibid*

<sup>6</sup> See, eg. Chapter Two, 'Risks associated with a changing climate', in the Climate Commission's 2011 *the Critical Decade Report*, stored at <http://resources.news.com.au/files/2011/05/22/1226060/682675-aus-news-file-climate-change-11-05-22.pdf>, accessed November 15 2013

<sup>7</sup> January 2014 OECD 'Environment at a Glance 2013 OECD Indicators', stored at: [http://www.keepeek.com/Digital-Asset-Management/oecd/environment/environment-at-a-glance-2013\\_9789264185715-en#page44](http://www.keepeek.com/Digital-Asset-Management/oecd/environment/environment-at-a-glance-2013_9789264185715-en#page44)

those targets by ensuring effective calibration against developments in climate science and global action.

A strong example of an equivalent climate-oriented organisation is the UK Climate Change Committee, which has had bipartisan support, is widely respected, and which has recommended and monitored the UK's five-year carbon budgets. The UK Climate Change Committee is credited with ensuring that UK climate policy has remained moderate and stable.

**The Direct Action Plan (DAP) policy suite will not drive long term structural decarbonisation of the Australian economy, and the DAP suite pollution reduction targets are far too low. Climate change will not end in 2020 and business decisions being taken now and up to 2020 will have costly impacts for decades to come.**

An appropriate Australian climate policy will drive pollution reductions in line with objectives determined by reference to the best available science, and robust analysis of the risks posed by different global warming scenarios. It is clear that the threat climate change poses to our ecological life-support systems is such that strong decarbonisation goals should be adopted – in ACF's view, policies consistent with Australia's equitable contribution to global efforts that give us an 80% chance of limiting warming to 1.5 degrees. Appropriate pollution reduction targets should be legislated at a 40% reduction on 1990 levels by 2020, 60% by 2030 and zero net pollution by 2050.<sup>8</sup> Pollution reduction of this magnitude requires the development of public policy instruments that support a structural transition towards a low pollution future – in particular instruments that allow for a fast transition away from high pollution sources of energy generation.

Climate change will not end in 2020; nor will the impacts on business of investment decisions made now. However, the DAP makes no provision for what happens with Australian climate policy after 2020. This short-termism is demonstrated by the five year time limit under the DAP for tender contracts – undermining the chances of important and transformative abatement projects that span 20 to 30 year timeframes securing funding.

ACF urges the Australian government to ensure proper attention is paid to the environmental and business case for long term pollution targets (ie, to 2050). These provide the structure and certainty business needs to make good decisions and investments. As presently calibrated, the DAP's short term goals are too low, and the government's policy possesses no longer term (post 2020) pollution reduction targets. The inadequate and short term nature of the DAP, along with its inability to deliver appropriate abatement, ensure that Australian business will continue to hedge against uncertainty, driving up the cost of doing business in Australia.

Furthermore, if passed into law, the *Clean Energy Act Repeal Bill* will remove Australia's legislated cap on pollution. The Government has indicated the Emissions Reduction Fund

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<sup>8</sup> See, e.g., ACF's submission to the Climate Change Authority's 'Caps and Targets Review', May 29 2013, at <http://consultation.climatechangeauthority.gov.au/climate-change-authority1/submissions/pdf/21.pdf>. Accessed January 10 2014

scheme will have no legislated cap on pollution, nor any mechanism (inclusive of increases in funding in the case of pollution abatement undershooting target trajectories) to ensure that Australia's pollution reduction targets are satisfied. Government has also committed to capping spending on the ERF scheme, ruling out the possibility that government can ensure pollution reduction through appropriation of additional project funding.<sup>9</sup>

ACF notes the DAP's central policy instrument, the ERF, gives an incentive to some businesses to reduce their carbon pollution – those companies that 'win' government grants to reduce their pollution. The scheme provides no incentives to other businesses to reduce pollution; indeed, the structure of the system has the perverse impact of incentivizing companies to maintain high levels of pollution in order that they can obtain pollution reduction funding in future grant rounds.

### **The DAP fails to honour Australia's existing international pollution reduction goals.**

The DAP is structured around an inflexible 5% target, a decarbonisation target lower than that to which Australia has committed at a sequence of international forums, inclusive of meetings of the UN Framework Convention on Climate change at Cancun in 2010<sup>10</sup> and at Doha in 2012.<sup>11</sup> At these forums the Australian government committed to develop policies in line with international action consistent with ensuring global warming does not exceed two degrees centigrade,<sup>12</sup> with additional commitments to 'triggers' for scaling up Australian decarbonisation efforts, indexed to international action.<sup>13</sup> The Climate Change Authority's draft report has indicated that the conditions for raising Australia's target to 15% by 2020 have been met.<sup>14</sup> It is also to be noted that the decarbonisation achievements of comparable economies has far outstripped our own; the US State Department recently reported, for instance, that the USA will achieve its 17% 2020 decarbonisation target.<sup>15</sup>

It is firmly in Australia's national interest to act constructively in international forums to develop agreements that reduce the risk of run-away climate change. Australia's current unconditional and inadequate 5% decarbonisation pledge will hinder Australia's ability to play any positive role in such discussions. In light of these concerns, ACF urges the

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<sup>9</sup> Prime Minister Abbott, when pressed during the 2013 election campaign on modelling which suggests that the ERF will fail to achieve targets without considerably higher expenditure, stated: "I want to just say of our direct-action policy that it's funded, it's costed and it's capped." See Jonathan Swan, 'Liberals cap spending on climate change policy':

<http://www.smh.com.au/federal-politics/federal-election-2013/liberals-cap-spending-on-climate-change-policy-20130817-2s3q0.html#ixzz2kgs51Nhl>, retrieved January 11, 2014

<sup>10</sup> See [http://unfccc.int/meetings/cancun\\_nov\\_2010/meeting/6266.php](http://unfccc.int/meetings/cancun_nov_2010/meeting/6266.php), accessed January 10 2014

<sup>11</sup> See [http://unfccc.int/meetings/doha\\_nov\\_2012/meeting/6815.php](http://unfccc.int/meetings/doha_nov_2012/meeting/6815.php), accessed January 10 2014

<sup>12</sup> In the Climate Change Authority's recent report 'Targets and process: review' it has considered what might constitute Australia's fair share of an estimated global emissions budget. The Authority's view is that an Australian emissions budget of 10,100 Mt CO<sub>2</sub>-e for the period 2013 to 2050 (or around 1 per cent of the estimated global budget) would represent an equitable share. See: <http://climatechangeauthority.gov.au/Node/100>

<sup>13</sup> *Ibid.*

<sup>14</sup> Climate Change Authority, 'Reducing Australia's Greenhouse Gas Emissions: Targets and Progress Review Draft Report', at <http://climatechangeauthority.gov.au/content/reducing-australia%E2%80%99s-greenhouse-gas-emissions-targets-and-progress-review-draft-report-0>, accessed January 10 2014

<sup>15</sup> '2014 Climate Change Report', US State Department Document, stored at <http://www.state.gov/e/oes/climate/ccreport2014/index.htm>

Australian government to commit to a significant increase in Australia's decarbonisation target prior to the September 2014 Ban Ki Moon convened world leader's climate summit.<sup>16</sup>

ACF is not aware of any independent modelling that suggests that the Direct Action Plan will deliver on the government's 5% pollution reduction target. Danny Price, Managing Director at Frontier Economics, has stated the view that the DAP will require additional funding in the range of \$7-\$10 billion to achieve this goal.<sup>17</sup> Similar results were outputted from modelled by Sinclair Knight Mertz/MMA, who have suggested that the DAP will likely see an increase in Australia's pollution of between 8—10% to 2020<sup>18</sup>, while SKM's view is that spending of an additional \$4 billion above current spending will be required to ensure that Australia meets a 5% target. Reputex has found the ERF is likely to see a 13 per cent *rise* in Australia's pollution, not a 5% fall.<sup>19</sup> These reports are extremely concerning. The government appears to be preparing to take a set of laws that are capable of delivering 5% pollution reduction to 2020, in order to replace them with an approach to pollution reduction that few independent analysts believe will come even close to achieving stated scheme objectives.

Additionally, modelling suggests that the costs of the scheme will become unsustainable if it is scaled up to achieve evidence based decarbonisation objectives indexed to Australia's existing decarbonisation commitments (action in line with a two degree decarbonisation target).

The CCA has stated that under the ETS, the 15—25% target by 2020 could be achieved with 'relatively small cost.' Increasing targets to 15—25% by 2020 will only hamper Australian economic growth if trading in international pollution permits is prohibited. When international trading is permitted, CCA modelling shows pollution reduction will lead to a reduction of 0.02% of GNI growth per person under a 15% 2020 target, or 0.04% of GNI growth per person under a 25% target.<sup>20</sup> In contrast, the CCA review has found that the DAP would be 'extremely difficult' to scale up to a higher target than 5% by 2020,<sup>21</sup> as such scaling would be 'prohibitively expensive'.<sup>22</sup> The Hon Malcolm Turnbull MP notes that the government funded scheme into the long term would be 'a very expensive charge on the

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<sup>16</sup> <http://www.un.org/climatechange/blog/2013/09/24/ban-ki-moon-invites-world-leaders-to-a-climate-summit-in-2014/>

<sup>17</sup> See ABC interview at <http://www.abc.net.au/lateline/content/2013/s3889678.htm>; accessed January 10 2014.

<sup>18</sup> 'A Review of Subsidy and Carbon Price Approaches to Emission Reduction', Sinclair Knight Mertz: [http://www.climateinstitute.org.au/verve/\\_resources/SKM\\_ReviewofSubsidyandCarbonPriceApproaches\\_August2013.pdf](http://www.climateinstitute.org.au/verve/_resources/SKM_ReviewofSubsidyandCarbonPriceApproaches_August2013.pdf), accessed January 10 2014; see also 'Climate Change Policy and the National Climate Interest', Climate Institute Report, at [http://www.climateinstitute.org.au/verve/\\_resources/TCI\\_CoalitionClimatePolicyandtheNationalClimateInterest\\_15August2013.pdf](http://www.climateinstitute.org.au/verve/_resources/TCI_CoalitionClimatePolicyandtheNationalClimateInterest_15August2013.pdf); report accessed January 10 2014.

<sup>19</sup> Reputex, 'Approaches to calculating emissions intensity baselines', accessed January 10 2014, [http://www.reputex.com/wp-content/uploads/2013/11/RepuTex-CMU\\_Approaches-to-calculating-emissions-intensity-baselines-11131.pdf](http://www.reputex.com/wp-content/uploads/2013/11/RepuTex-CMU_Approaches-to-calculating-emissions-intensity-baselines-11131.pdf)

<sup>20</sup> Climate Change Authority, 'Reducing Australia's Greenhouse Gas Emissions: Targets and Progress Review Draft Report', at <http://climatechangeauthority.gov.au/content/reducing-australia%E2%80%99s-greenhouse-gas-emissions-targets-and-progress-review-draft-report-0>, accessed January 10 2014

<sup>21</sup> Climate Change Authority, 'Reducing Australia's Greenhouse Gas Emissions: Targets and Progress Review Draft Report', at <http://climatechangeauthority.gov.au/content/reducing-australia%E2%80%99s-greenhouse-gas-emissions-targets-and-progress-review-draft-report-0>, accessed January 10 2014

<sup>22</sup> See, e.g., <http://www.theguardian.com/environment/2013/oct/30/climate-change-abbott-emissions-target>

budget in the years ahead'.<sup>23</sup> Similar views were expressed by Treasury in its 2010 'Blue Book', prepared for an incoming Coalition government. Treasury described a carbon-pricing mechanism as 'the only realistic way of achieving the deep cuts in emissions that are required', and also identified 'scaling up' from 5% pollution reduction as the a major problem with the Coalition policy, saying 'a market mechanism can achieve the necessary abatement at a cost per tonne of emissions that is far lower than alternative direct action policies. Moreover, many direct action measures cannot be scaled up, and, for those that can, the cost per tonne of abatement would rise rapidly, imposing further costs on taxpayers and consumers. All of this serves to underscore the conclusion that the sooner an emissions trading scheme can be implemented the better.'<sup>24</sup>

Delaying deep emission cuts till after 2020 will have high economic costs.<sup>25</sup> A rapid and unprecedented acceleration of emission reduction would need to follow in order to reach the CCA target of 30—50% reduction by 2030. Such rapid increase in emissions reductions could irreconcilably damage the Australian economy.

### **Prior experiences with policies possessing similar structure shows they fail to deliver low-cost pollution reduction**

ACF is not aware of any mitigation policies similar to the DAP that have delivered large scale pollution reduction at low cost. This is an issue that has been raised by institutional investors during DAP consultation.<sup>26</sup> Grant/tender structured GHG mitigation policies have failed to deliver on goals for a range of reasons. A 2010 review of Australian climate policies was conducted by the Auditor-General. A key finding was that the success of pre-ETS programs aimed at reducing Australian greenhouse gas pollution was undermined by a range of structural problems and that they thus under-delivered pollution reduction. In particular, schemes were undermined by difficulties caused by bidding organisations failing to deliver on commitments, along with operational difficulties arising during the implementation of projects (see additional detail in box below).<sup>27</sup>

**The failure of the Greenhouse Gas Abatement Program (GGAP).** The Howard government's Greenhouse Gas Abatement Program (GGAP) was a greenhouse gas pollution reduction policy that closely resembles the ERF. The GGAP saw the government invest \$400 million over four years funding abatement programs aimed at reducing pollution by 51.5 Mt CO<sub>2</sub>, using the same basic grant/tender structure possessed by the ERF. The program was reviewed by the Auditor-General, who found that the GGAP only managed to reduce emissions by 15.5 Mt CO<sub>2</sub> over four

<sup>23</sup> <http://www.abc.net.au/lateline/content/2011/s3220679.htm>, accessed January 10 2014

<sup>24</sup> <http://www.scribd.com/doc/38100930/Redacted-Blue-Book-Pt2>, accessed January 10 2014

<sup>25</sup> Climate Institute,  
[http://www.climateinstitute.org.au/verve/resources/TCI\\_Submission\\_EmissionReductionFund\\_November2013.pdf](http://www.climateinstitute.org.au/verve/resources/TCI_Submission_EmissionReductionFund_November2013.pdf)

<sup>26</sup> See, e.g., the Investor Group on Climate Change ERF Submission to the first round of consultation with regards to the Emissions Reduction Fund, stored at  
[http://www.igcc.org.au/Resources/Documents/IGCC%20Submission\\_ERF\\_131118\\_IGCC%20template%202.pdf](http://www.igcc.org.au/Resources/Documents/IGCC%20Submission_ERF_131118_IGCC%20template%202.pdf).

<sup>27</sup> 'Administration of Climate Change Programs', The Auditor-General Audit Report No.26 2009–10, stored at  
[http://www.anao.gov.au/uploads/documents/2009-10\\_Audit\\_Report\\_26.pdf](http://www.anao.gov.au/uploads/documents/2009-10_Audit_Report_26.pdf), accessed January 10 2013.

years (30% of intended abatement) with the programme under-spending by \$132 million to its 2009 termination.<sup>28</sup> The Auditor-General attributed underperformance to partly to delays in finalization of funding agreements, but also to the termination of 40 per cent of funded projects – largely due to organisations bidding in with unsustainably low quotes for pollution reduction, before abandoning projects. A major problem was that the fund did not attract a sufficient number of competitive proposals, which ‘seriously weakened the capacity of the department to deliver the anticipated abatement.’<sup>29</sup>

While the failure of grant/tender type schemes of the direct action type is easy to predict, it is hard to avoid – especially if the objective of the government is delivery of low-cost abatement. Strong delivery of pollution will require:

- Strong screening of projects in order to ensure that winning tenderers have robust approaches to pollution reduction and realistic budgets.
- Working with bidders to ensure pollution reduction programmes are robust.
- A system of compliance measures to ensure that pollution reduction commitments are met.

The cost of these measures will be threefold:

- Direct administrative burden on government.
- Complexity of process will act as a disincentive to participation, especially with smaller businesses (eg, agriculturalists).
- Compliance costs will lead to higher-cost abatement than achieved under the simpler carbon pricing mechanism.

The ineffectiveness of the DAP policy suite (low ambition, poor scalability) will lock in policy uncertainty, which will lead to poor outcomes both for business and the environment. Problems specific to the scheme’s architecture flow from (among other things) complexities of baseline settings, inequities, problems with baseline compliance mechanisms and monitoring, and inequities and perverse influence to pollute.

### **The DAP locks in long term instability**

As mentioned above, investment predictability relies on long term policy stability, which can only flow from long-term evidence-based target-setting combined with. The weak and short term nature of DAP targets locks in the certainty that Australia climate policy will remain fluid over coming years.<sup>30</sup> As climate impacts become more apparent, Australia will come under growing international pressure to adopt stronger decarbonisation targets. The Coalition’s chosen pollution reduction machinery will not be able to deliver higher

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<sup>28</sup> ANAO Audit report No.34 2003–04 – GGAP

<sup>29</sup> ANAO Audit report No.34 2003–04 - GGAP

<sup>30</sup> This argument is made, for instance, in the Investor Group on Climate Change ERF Submission to the first round of consultation with regards to the Emissions Reduction Fund, stored at [http://www.igcc.org.au/Resources/Documents/IGCC%20Submission\\_ERF\\_131118\\_IGCC%20template%202.pdf](http://www.igcc.org.au/Resources/Documents/IGCC%20Submission_ERF_131118_IGCC%20template%202.pdf).

decarbonisation without considerable additional expenditure. The scheme's pollution comes at a premium caused by compliance costs and companies hedging against uncertainty regarding delivery, with the additional threat of non-additional abatement. These problems will be exacerbated as low-cost abatement opportunities are exhausted, leaving only more expensive decarbonisation opportunities. Furthermore, the investment community has indicated that it requires at least a 20-year time frame to be in a position to make sound long-term investment decisions.<sup>31</sup> In the absence of such policy stability, business will continue to hedge and delay investment decisions, driving up the cost of business and reducing productivity.

### **Complexities of baseline setting**

The government's chosen approach to climate policy relies on the identification and monitoring of pollution baselines against which the pollution achievements of businesses can be evaluated. Any scheme structured around pollution baselines opens itself to rent seeking, intensive industry lobbying, perverse incentives to pollute, and the risk of muddy, complex, inefficient climate policy. More transparent market mechanisms are not accompanied by these negative corollaries. A great deal of thought must be given to developing an approach to baseline setting that is able to ensure that appropriate baselines are set and that penalty systems are robust enough to help shape behaviour and business and consumer investment decisions. ACF is particularly concerned that any proposed baseline setting process should provide: (i) strong coverage of the economy; and (ii) baselines should not indirectly support existing dirty plant and business practices; (iii) that sufficiently strong compliance/penalty schemes exist to ensure pollution does not actually *rise* under operation of the scheme.

The political perils of development of climate policies structured around enforcement of pollution baselines can be illustrated by reference to the Canadian Harper government's failed attempt to implement a scheme similar to the Emissions Reduction Fund. That scheme was abandoned in the face of opposition directed at the complexity of the process around baseline setting.<sup>32</sup> More recently, the development of the declining baseline system used to incentivize pollution reduction in Australian emissions-intensive trade exposed industries required considerable negotiation and time, while development of the CFI (which relies on establishing appropriate baselines) also ran several years over time.

Business concerns with regards to the DAP cluster around the setting of pollution baselines.<sup>33</sup> Important business stakeholders such as the Minerals Council (MCA), the Business Council (BCA) and the Australian Industry Group (AIG) have raised concerns about the potential for business competitiveness of different sectors to be undermined by the ERF. They have recommended that the Productivity Commission review and provide guidance with the development of the DAP. The BCA and other industry groups have also requested that proposed baseline methodologies should be tested first to ensure that

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<sup>31</sup> See *ibid.*

<sup>32</sup> <http://www.pembina.org/op-ed/1661>

<sup>33</sup> Industry stakeholders such as BCA and AIG have raised concern over the complexities of baseline methodologies.

industry sectors are not unfairly disadvantaged. The Minister for Environment has accelerated the drafting period of the DAP, with the result that implementation of the policy is likely to be fraught with difficulties and complexities, and at present it seems unlikely that the requests of the MCA/BCA/AIG will be heeded.

Experience has shown that it is difficult to set equitable baselines that both satisfy business and industry on the one hand, and that are capable of meeting environmental objectives on the other. With regards to business interests, sensitivity is required to ensure that business growth and expansion are not stifled, that businesses exposed to international trade are not overly disadvantaged, and that external factors such as global commodity prices or foreign exchange rates do not undermine the effectiveness of the scheme. With regard to environmental concerns, it is important that baselines are structured such that they do not create perverse incentives to pollute, that they cover the appropriate parts of the economy, and that penalties for non-compliance are sufficiently strong that companies are incentivized to decarbonise their operations. ACF is particularly concerned about the Minister for the Environment's recent ruling out of financial penalties for companies that exceed baselines. The Minister is yet to give an indication of the type of compliance mechanism he prefers. Equally concerning are indications that the Clean Energy Regulator will be given the power to vary pollution reduction contracts arising in circumstances of under-delivery, suggesting that the government is building in flexibility with regards to projects that undershoot pollution reduction commitments.

### **Inequities and perverse incentives**

As presently structured, the Coalition's plan disadvantages responsible companies that have already reduced pollution.<sup>34</sup> The Australian Industry Group (AIG) has expressed concern that energy efficiency mechanisms already in place will be counted as business as usual (BAU) and therefore they would not be eligible to enter the auction. Further, the government's lowest-cost abatement model may encourage businesses to submit speculative tenders that out-compete other genuine bids but then do not deliver sufficient abatement, undermining the environmental integrity of the scheme.<sup>35</sup> The structure of the ERF allows considerable opportunity for rorting, with companies able to manipulate the calculation of the baselines, allowing for creation of 'grey' pollution reduction. Furthermore, it is to be noted that information asymmetries favour larger businesses, with identification of abatement opportunities requiring knowledge of effective and reliable investments into cleaner energy investments. Such opportunities typically lie beyond the knowledge base of smaller businesses, who are generally unable to secure consultant or other advice. Further, identification of appropriate technologies and solutions increases costs for all businesses, but particularly smaller one, who struggle to know to which supplier they should turn.<sup>36</sup>

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<sup>34</sup> AIG submission to Emissions Reduction Fund consultation, see 'Designing Direct Action Emissions Reduction Fund', by Energetics, at: <http://www.energetics.com.au/insights/latest-news/climate-change-matters/design-direct-action-emissions-reduction-fund-erf>

<sup>35</sup> *Ibid.*

<sup>36</sup> CEFC submission, Direct Action Plan consultation process, stored at: [http://www.cleanenergyfinancecorp.com.au/media/65401/cefc\\_submission\\_erf\\_terms\\_of\\_reference.pdf](http://www.cleanenergyfinancecorp.com.au/media/65401/cefc_submission_erf_terms_of_reference.pdf), accessed January 10, 2014.

## The Emissions Reduction Fund can act as a complementary measure

In his explanations to date of the proposed operation of the DAP, the Minister for the Environment has made frequent reference to Norwegian climate policy as an example of successful climate policies possessing structure similar to the Emissions Reduction Fund in other jurisdictions. However, Norwegian climate policy more closely resembles Australia's existing climate policies with carbon pricing. Norway has:

- A 30% by 2020 decarbonisation goal.
- A carbon tax, including on inclusive of a tariff on Norway's exports of oil and gas.
- An emissions trading system that covers 40% of Norway's GHG pollution.
- Links with the EU emissions trading scheme and to international carbon markets.

Although Norway's fund purchases abatement projects similar to the DAP's ERF, their function and focus are different. Norway's Commercial Carbon Procurement Program was established in order to support UN approved abatement projects stranded due to the collapse of global carbon prices.<sup>37</sup>

ACF view is that the ERF/DAP architecture has a useful role to play in Australian climate policy as a complement to a more effective, long term and robust pollution reduction policy. An ERF structured grant/tender might complement, for instance:

- An emissions trading scheme possessing science based long term pollution caps, with coverage over most of the economy.
- A baseline-and-credits type system, with robust and declining baselines and a strong penalty system.
- Sector specific greenhouse gas abatement regulation.<sup>38</sup>

*The Australian Conservation Foundation strives to advance lasting solutions to Australia's environmental problems and to create a sustainable future and better quality of life.*

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<sup>37</sup> With regards to this, see (e.g) Sarah Rundell's 'Carbon Credits Gets a Boost', at: <http://www.top1000funds.com/news/2013/11/27/carbon-credit-market-gets-a-boost/>

<sup>38</sup> An example of decarbonisation through strong sector specific regulation are the moves that President Barack Obama has recently signaled in the United States. The two most important elements of these regulations are those aimed at reducing the emissions intensity of electricity generation by imposing pollution limits, and those that mandate fuel economy standards for Model Year 2014-2018 heavy-duty trucks, buses, and vans.