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**SUBMISSION**

# Interim Emissions Reduction Targets for Victoria (2021-2030)

May 2018

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**The Business Council of Australia draws on the expertise of Australia's leading companies to develop and promote solutions to the nation's most pressing economic and social challenges.**

## **ABOUT THIS SUBMISSION**

The Business Council supports the development of an integrated, national and bipartisan energy and climate change policy framework that can deliver the following four key goals:

- secure and reliable energy supply
- affordable energy supply
- strong, internationally competitive economy
- meet current and future absolute emission reduction targets.

The Victorian Government's *Climate Change Act 2017* (the Act) establishes a framework to achieve a 'net zero emissions, climate-resilient Victorian community and economy by 2050.' The Act requires the Victorian Government to set five-yearly interim emissions reduction targets to meet the long-term net zero emissions goal. An Independent Expert Panel (the Panel) has been appointed to provide advice to the Victorian Government on: the first two sets of interim targets for 2021-25 and 2026-30; indicative trajectories to meet these targets; and, potential emissions reduction opportunities across sectors of the economy.

In March 2018, the Panel published an Issues Paper on a range of issues relating to interim emissions reduction targets and the advice sought by the Victorian Government.

This submission responds to matters raised in the Panel's Issues Paper.

## KEY RECOMMENDATIONS

- ▶ The Business Council does not support state-based targets operating alongside a federal emissions reduction target.
- ▶ The Business Council has consistently emphasised the importance of avoiding state-based policy divergence in national markets such as electricity.
  - State-based schemes – such as state-based renewable energy targets like the Victorian Renewable Energy Target (VRET) – distort the operation of the National Electricity Market and this can be particularly damaging to the investability, reliability, affordability and long-term transformation of the whole electricity sector, while actually increasing the costs of renewable energy projects.
  - State-based renewable energy targets do not lead to efficient investment outcomes and only serve to drive up the cost of achieving carbon emission abatement at a national level
- ▶ The Business Council supports a nationally coordinated emissions reduction policy framework that recognises the fact that climate change is a global problem, and that as Australia has a nationwide abatement commitment it does not matter where abatement occurs.
- ▶ The Business Council calls on the Victorian Government to support the implementation of the National Energy Guarantee as the most appropriate mechanism to properly integrate energy and climate change policy and to manage the energy sector's transition as we shift to a lower emissions economy.
- ▶ The Business Council calls on the Victorian Government to lift its moratorium on the development of gas reserves. This will bring more gas into the market, which will be critical to managing the transition of our energy system and shifting to a lower emissions future.
- ▶ The Business Council urges the Panel to consider the extent to which emissions-intensive trade-exposed businesses contribute towards meeting interim targets. A balance must be struck between our commitment to reduce emissions and the need to preserve our economic prosperity and the trade competitiveness of our industry. These must be treated as equally important objectives.

## INTRODUCTION

The Business Council of Australia welcomes the opportunity to provide feedback on the Independent Expert Panel's Interim Emissions Reduction Targets for Victoria (2021-2030) Issues Paper.

Unconstrained climate change would have serious economic, environmental and social consequences for Australia. The 21<sup>st</sup> Conference of the Parties meeting in Paris in December 2015 reached a historic agreement (the Paris Agreement) to limit global temperature rises to 'well below two degrees Celsius.' To achieve this, deep global emissions reductions will be required with most countries, including Australia, eventually reducing net greenhouse gas emissions to zero.

Australia needs a suite of durable climate change policies that are integrated with broader energy policy and can deliver Australia's emission reduction targets at lowest possible cost, while maintaining competitiveness and growing Australia's economic prosperity.

The Business Council supports the development of an integrated, national and bipartisan energy and climate change policy framework that can deliver the following four key goals:

- secure and reliable energy supply
- affordable energy supply
- strong, internationally competitive economy
- meet current and future emission reduction targets.

Energy and climate change policies should also be consistent with the following principles:

- durable and national wherever possible, driven by bipartisan support
- capable of achieving our committed emission reduction targets at lowest possible cost while maintaining our competitiveness
- scalable to meet future emission reduction targets while managing risk and uncertainty
- flexible in the face of changing technology costs and consumer preferences
- investable across all sectors and time horizons and provide confidence that long-term investment decisions can be made and adequate returns earned
- facilitate well-functioning energy markets, security of supply and cost-effective energy delivery
- regain our energy comparative advantage.

A suite of energy and climate change policies is required to meet the above four goals.

Together with the development of the National Energy Guarantee, the Emissions Reduction Fund (ERF) remains a cornerstone of the Commonwealth Government's national emissions reduction efforts. In the coming years, we support the development of a long-term, national, whole-of-economy emissions reduction strategy that consolidates these energy and climate change policies into a comprehensive, integrated, durable policy framework.

## INTERIM TARGETS

In 2016 the Australian Government ratified the Paris Agreement and set a target to reduce Australia's emissions by 26 to 28 per cent below 2005 levels by 2030.

In recent years, Australia's climate change policies have been largely uncoordinated and inconsistent with broader energy policy, poorly costed and, at times, have operated at cross purposes with each other.

Because of the scope for inconsistency and higher than necessary costs to achieve any given emissions reduction, the Business Council does not support state-based targets operating alongside federal targets. Indeed, we have consistently emphasised the importance of avoiding state-based policy divergence in national markets such as electricity.

The *Climate Change Act 2017* establishes a long-term target of net zero greenhouse gas emissions by 2050 for Victoria. Under the Act, five-yearly interim emissions reduction targets will be set to meet this long-term goal. Over recent years, the Victorian Government has announced a range of policy measures that are aimed at dealing with the challenges presented by climate change. Encouraging the take-up of low-emission vehicles in Victoria, the TAKE2 Pledge program and programs such as the Victorian Climate Change Adaptation Plan 2017-2020 are all positive developments that serve to demonstrate the constructive role that Victoria can play in this policy space.

However, state-based schemes – such as state-based renewable energy targets like the Victorian Renewable Energy Target (VRET) – distort the operation of the National Electricity Market and this can be particularly damaging to the investability, reliability, affordability and long-term transformation of the whole electricity sector, while actually increasing the costs of renewable energy projects. State-based renewable energy targets do not lead to efficient investment outcomes and only serve to drive up the cost of achieving carbon emission abatement at a national level.

Further, states with their own targets will ultimately do a greater share of the emissions reduction required under a national target compared to those states and territories that do not have their own state-based targets, but rather, adhere to the national target. Competing targets will distort market decisions and likely result in carbon leakage, as identified in the Issues Paper itself.<sup>1</sup>

Therefore, the Business Council supports a nationally coordinated emissions reduction policy framework that recognises the fact that climate change is a global problem, and that as Australia has a nationwide abatement commitment it does not matter where abatement occurs.

As such, if Victoria wishes to pursue interim emissions reduction targets, then it is essential that those targets relate to a national reference point – currently Australia's emissions reduction target of 26 to 28 per cent below 2005 levels by 2030. Going forward, setting of the interim targets should align with the Commonwealth Government's five-yearly review and refine cycle under the Paris Agreement to ensure there is a nationally consistent approach to emissions reduction that will not distort market decisions or result in carbon leakage.

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<sup>1</sup> Independent Expert Panel, *Interim Emissions Reduction Targets for Victoria (2021-2030) Issues Paper*, March 2018, p. 30.

## EMISSIONS REDUCTION OPPORTUNITIES

Most emissions in Australia are generated in the electricity, built environment, transport, industrial processes and agriculture sectors. Efforts will need to focus on all areas to achieve emissions reduction targets at lowest possible cost.

### Electricity generation

The Issues Paper identifies electricity generation as the sector with ‘the largest currently identified, cost-effective potential to reduce emissions through reductions in energy demand through reductions in energy demand and shifting to low carbon electricity generation.’<sup>2</sup>

Australia’s electricity system is undergoing a major transition. An increase in the amount of intermittent technology, such as wind, solar and storage has resulted in a fall in dispatchable coal-fired generation. Since 2012, more than 5,000MW of ageing coal-fired generation capacity has been withdrawn from the National Electricity Market (NEM) with a further 2,000MW scheduled to close in 2022. In contrast, since 2016, over 6,500MW of new renewable capacity has been announced under the Federal Renewable Energy Target (RET).

Victoria’s Hazelwood coal-fired power station was the tenth coal-fired power station to close in the NEM since 2012 and, according to the Australian Energy Regulator (AER) its closure has had a significant impact on the market.<sup>3</sup> At the time of its closure in March 2017, Hazelwood had a ‘significant presence in the Victorian wholesale market, representing around 15 per cent of installed capacity and supplying 20 per cent electricity in the state.’<sup>4</sup> In fact, since its closure Victoria has gone from being a net energy exporter to a net importer.<sup>5</sup> The key finding of the AER’s March 2018 report states:

... the exit of Hazelwood removed a significant low fuel cost generator which was largely replaced by higher cost black coal and gas plant – at a time when the input costs of black coal and gas plant were increasing. These factors in turn drove significant increases in wholesale electricity prices. Annual average wholesale electricity prices in Victoria in 2017 were the highest they have been since the commencement of the NEM.<sup>6</sup>

The AER concludes that average spot prices for 2017 for Victoria increased 85 per cent on 2016, with consistently significant rises across other NEM jurisdictions (which have also been impacted by Hazelwood’s closure).<sup>7</sup> With the Australian Energy Market Commission (AEMC) estimating that the wholesale electricity component makes up more than a third of residential electricity market offer prices in Victoria, these significant wholesale prices increases will likely flow onto the consumer.<sup>8</sup> Indeed, the AEMC has said that ‘residential electricity market offer prices for the representative consumer in Victoria are estimated to increase by 15.9 per cent from 2016/17 to 2017/18.’<sup>9</sup>

2. *ibid*, p. 24.

3. Australian Energy Regulator, *AER electricity wholesale performance monitoring: Hazelwood advice*, March 2018, p. 1.

4. *ibid*.

5. *ibid*.

6. *ibid*, pp.1-2.

7. Australian Energy Regulator, *Wholesale electricity prices higher since Hazelwood exit*, 29 March 2018.

8. Australian Energy Market Commission, *2017 Residential Electricity Price Trends*, 18 December 2017, p.118.

9. *ibid*.

Therefore, the Business Council urges the Panel to consider the potential ramifications of shifting too quickly to greater renewable generation without properly ensuring there is adequate dispatchable generation capacity. The 2016 experience in South Australia demonstrated the tension that can arise as the market moves away from emissions intensive generation and towards lower emissions generation. Australia, and particularly Victoria if it continues to pursue its VRET, need to manage the transition away from emissions intensive generation in an orderly manner that supports capital decision making and ensures system reliability at the lowest possible cost to customers.

The Business Council calls on the Victorian Government to support the implementation of the National Energy Guarantee as the most appropriate mechanism to manage the energy sector's transition as we shift to a lower emissions economy. By relying on existing market structures and placing responsibility for meeting emissions and reliability targets on electricity retailers, the Guarantee is our best chance to drive the investment we need in the energy sector, while also meeting our emissions reduction targets.

The changing mix of generation in Australia has led to higher prices and a less stable and reliable energy system. The Guarantee seeks to manage this transition by providing a clear investment signal to build dispatchable electricity generation and encourage the lowest cost range of technologies to meet overall targets. The proposed Guarantee provides a credible pathway forward and can put an end to the political impasse and policy paralysis and be a circuit-breaker for the stale energy and climate change policy debate in this country.

Importantly, the Panel should consider the potential impact of the Guarantee's reliability requirement on retailers in its advice to government on interim targets. As currently proposed, this requirement will apply to retailers in each NEM-region and consequently states that pursue state-based renewable energy targets are likely to disproportionately increase the need for dispatchable resources to support the integration of large volumes of intermittent wind and solar generation in their jurisdiction. This will increase the likelihood of a reliability gap emerging, which will in turn increase the likelihood of the reliability requirement being triggered. Triggering the reliability requirement in a region will result in additional compliance burdens and costs on retailers which will ultimately be borne by the electricity consumers in that state.

Finally, the Business Council urges Victorian Government to lift its moratorium on the development of gas reserves to bring more gas supply into the market. The moratorium does not reflect scientific assessment, with Australia's Chief Scientist, Dr Alan Finkel AO, recommending in his *Independent Review into the Future Security of the National Electricity Market* that 'governments should adopt evidence based regulatory regimes to manage the risk of individual gas projects on a case-by-case basis.'<sup>10</sup> Indeed, the report cautions that '...regulatory restrictions not based on evidence have long-term detrimental impacts on gas exploration and development and disrupt the flow of gas.'<sup>11</sup> A March 2018 report by the Australian Energy Market Operator (AEMO) has warned that 'without additional gas supply, there is a potential shortfall in meeting annual Victorian gas consumption from 2022.'<sup>12</sup> It is expected gas will act as a transition fuel as our energy system moves towards lower

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10. Dr Alan Finkel AO, *Independent Review into the Future Security of the National Electricity Market: Blueprint for the Future*, June 2017, p.116.

11. *ibid.*

12. Australian Energy Market Operator, *Victorian Gas Planning Report Update*, March 2018, p. 3.

emissions generation and therefore more supply in the market will be increasingly important in the coming years.

### **Transport, built environment, land and carbon offsets**

The Business Council supports encouraging greater energy efficiency, encouraging the adoption of more fuel-efficient vehicles and better management of land use and the agriculture sector. In our response to the Commonwealth Government's 2017 review of climate change policies we included comprehensive analysis of the emissions reduction opportunities in these key areas. Our submission can be found [here](#).

The Business Council has consistently supported emissions reduction policies that allow access to credible domestic and international permits to ensure compliance can be managed at least-cost. In particular, access to credible, high-quality international permits as a means for businesses to acquit their emissions liability at least-cost must be considered as part of the development of long-term, whole-of-economy emissions reduction strategy.

## POTENTIAL EFFECTS OF EMISSIONS REDUCTION

### Need to maintain competitiveness

The Issues Paper notes the potential costs of transitioning to a net zero emissions economy.

In particular it notes, ‘emissions-intensive, trade exposed sectors may see a decline in competitiveness, or movement of plants to outside Victoria (“carbon leakage”), if other states and countries have weaker emissions reduction policies than Victoria.’<sup>13</sup>

Climate change policy can impact the competitiveness of Australian industry in two key ways:

- *directly* as a result of emissions reduction obligations placed on a company or industry; and/or
- *indirectly* as a result of emission reduction policies impacting key inputs such as electricity and gas.

Since 2015, businesses with emissions-intensive trade-exposed (EITE) activity have been 100 per cent exempt under the RET. This recognises the need to maintain the international competitiveness of Australia’s trade exposed sectors, in the context of uneven global commitments to reduce emissions. It also recognises that driving these industries offshore would do little to reduce global emissions and could conceivably increase them, depending where the activity relocated. The Business Council supports maintaining consistency with the RET and exempting electricity used to undertake EITE activities from the emissions requirement under the National Energy Guarantee.

In the context of setting interim emissions reduction targets in Victoria, it will be necessary to consider the extent to which these trade exposed businesses contribute towards meeting the interim targets. A balance must be struck between our commitment to reduce emissions and the need to preserve our economic prosperity and the trade competitiveness of our industry. The Business Council urges the Panel to treat these as equally important objectives.

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13. Independent Expert Panel, *Interim Emissions Reduction Targets for Victoria (2021-2030) Issues Paper*, March 2018, p. 30.

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BUSINESS COUNCIL OF AUSTRALIA

42/120 Collins Street Melbourne 3000 T 03 8664 2664 F 03 8664 2666 [www.bca.com.au](http://www.bca.com.au)

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