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National leadership not unilateral action: A state's role in climate change policy

Grattan Institute submission to the Department of Environment, Land, Water and Planning consultation on Victorian Renewable Energy Auction Scheme.

Victorian Renewable Energy Auction Scheme: Submission from Tony Wood, Energy Program Director, and David Blowers, Energy Fellow at Grattan Institute

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1 Summary points

- Actions by state or territory governments to subsidise renewable energy are poor policy choices for two reasons:
 - The history of all such schemes, including the national Renewable Energy Target (RET), is to create fundamental conflict between government policy and the energy market. The consequences are broad and can be unintended and negative. They include risks to reliability and affordability, whilst their capacity to contribute to climate change objectives depends on broader policy outcomes.
 - Unilateral actions by state or territory governments when there are existing or pending federal policies in the same area will almost certainly result in either conflict or higher cost with no net environmental benefit.
- The Victorian Government has recently recommitted to a national agreement to coordinate energy and climate change policies. Recent events in South Australia have highlighted the risks of the alternative. If the Victorian Government is committed to a national approach, it should engage proactively and constructively with the COAG Energy Council to deliver effective and efficient integrated energy and climate change policies.
- The proposed scheme has the multiple objectives of job creation, economic development and reduced greenhouse gas emissions. This is a hard task. The government should release details of any benefit/cost analysis, including considering the implications for maintaining a reliable and secure electricity mix in Victoria if 40 per cent of the state's electricity is generated from intermittent sources within ten years.
- A key purpose of the Victorian renewable energy auction scheme is to provide investment certainty to deliver up to 5400 megawatts of additional capacity by 2025. This outcome will have consequences for the national market, the Victorian region and consumer costs. There is a fundamental conflict between such schemes and the market that the consultation paper fails to address, even as it grapples with complex payment mechanisms and risk allocation. The consequences are very hard to predict.
- If the Victorian Government proceeds with the auction scheme, then it should apply a capital grant program to meet the 2020 target and should not proceed with the 2025 target, at least until the full potential consequences have been assessed and addressed.

2 Introduction

This submission from the Grattan Institute responds to the Victorian Government's consultation paper on the Victorian Renewable Energy Auction scheme.

Grattan Institute is an independent think-tank focused on Australian domestic public policy. We aim to improve policy outcomes by engaging with decision-makers and the community.

We understand that the Department is seeking submissions on a range of issues associated with the design of an auction scheme. Yet there is limited scope in the consultation paper to address how the scheme is seen in a Federal climate change and renewable energy context, the extent to which it will impact on other states and its implications for the effectiveness or efficiency of the national or Victorian electricity market.

The most important outcome from this consultation will be to develop a scheme that delivers on the Victorian Government's outcomes at least cost to both Victorians and other Australians. Fundamentally, we have a concern that renewable energy support schemes are poor policy choices that have a history of delivering sub-optimal outcomes. This submission will seek to provide constructive feedback to the Victorian Government, while also providing a broader context for Australian climate change policies.

We make no comments on some of detailed questions raised in the consultation since they are best addressed by potential project proponents. The remainder of this submission seeks to address the terms of reference from a policy perspective.

3 State-specific renewable energy targets

There is understandable frustration amongst state and territory governments at the lack of credible, stable federal climate change policy. As in the last days of the Howard government, the wish to act is great and some climate change policies are politically popular.

Renewable energy is generally highly popular and Victoria's new renewable energy target appears to be great politics. But in a national context it is anything but great policy.

There are two core reasons for this. First, it is a policy aimed at increasing renewables, not at reducing greenhouse gases. To be clear, increased solar and wind power will be a direct result of Australia's actions to reduce emissions. But the opposite does not necessarily hold true.

Second, climate change is not a Victorian specific problem. It is a global problem and Australia, as a nation state within the global community, has made commitments and introduced – and will introduce in the future – national domestic policies to deliver on these commitments. Unilateral action by any state or territory will cut across these policies and may simply increase their cost without any net environmental benefit.

3.1 Renewable energy auctions as climate change policy

Renewable Energy Targets (RET) – either at a national or state level – are policies for which one intention is usually to help reduce emissions, albeit in particular ways. It is highly unlikely that

renewable energy targets would exist if governments were not seeking to tackle climate change.

Yet, if there is a national emissions constraint, then RETs simply become another industry policy. In the absence of reducing emissions as an objective, the consultation paper provides no rationale for pursuing jobs or economic development through renewables rather than through any other industry.

3.2 Climate change policy needs to consider the electricity sector

The COAG Energy Council has recognised the need to integrate energy and climate policies at a national level. Australia is not the only country where climate policies have been in conflict with the wholesale electricity market. For example, even national policies such as the LRET mean that an increasing portion of supply receives a significant part of its revenue outside the market. The result is to make the market increasingly irrelevant as a vehicle for efficient dispatch, investment and divestment.

Victoria is part of the National Energy Market (NEM). Action that occurs in Victoria can impact other states and vice versa. It is unclear whether appropriate consideration has been given to the impact that a Victorian auction scheme may have on the NEM.

- Will it impact on system reliability and security – not just for Victoria, but for other states?
- What are the consequences for Victoria if one of the major coal-fired power stations closes as a result of the 40 per

cent target?

- What are the consequences for South Australia?
- What does a renewable target mean for Victoria's transmission network?

3.3 State based policies can be detrimental to national policies

Adopting a state-based target where national targets exist or are likely to exist seems counterproductive. The most likely impact of such a scheme is to alter the mix or location of national emissions reductions or renewable generation. The end result will then be higher cost for no net environmental benefit.

There may be a case for state government intervention if, for the reasons outlined in the consultation paper, the federal LRET 2020 target does not look like it would be met. The certainty that government backing may give financiers may allow more renewables to be built than would otherwise be the case. Government action would significantly reduce the risk that retailers would fail to meet their liability under the scheme and the subsequent penalties imposed would not be passed on to consumers. (Effectively consumers pay for renewable energy without getting it).

Yet there appears to be no conclusive evidence that the 2020 target would not be met. This is very much a judgement call for the Victorian Government as much of the information that would help it make a decision is owned by commercial entities. Moreover, it would be in the best interest of any of these entities –

financiers, project proponents or electricity retailers – for the Victorian Government to embark on such a scheme.

The 2025 target avoids this issue by being additional – any RET certificates generated as the result of new renewable projects will be surrendered and not sold on to retailers. But this does not take into account future government policy. Following the end of the national LRET in 2020 there will be no national policy driving emissions reductions in the electricity sector. This is unlikely to remain the case for long with the federal government due to undertake a review of its climate change policies in 2017.

Committing in mid-2016 to a renewable energy auction scheme to secure projects after 2020 risks either stranding that scheme or interactions with the federal policy that are currently unforeseeable.

3.4 Impact on business certainty

We have little idea of what Australia's climate change (and renewables) policy will be post-2020. It is this uncertainty that has led to businesses being unwilling to invest in the low-emissions technologies we need, including renewables, to reduce emissions at lowest cost. While the Victorian Government has effectively guaranteed to have 5,400 megawatts of new renewable generation built by 2025, it will not necessarily create the intended certainty for investors.

Businesses are after stability and predictability – something that the Victorian Government will give to the successful bidders in their renewable energy auctions. But in a broader policy context, it is yet another change in an area that has been characterised by

instability and unpredictability for too many years. Some businesses and financiers may well act because they see increased activity in the market. But others may choose to hold off. Future changes – such as the introduction of other state schemes or Commonwealth action – may well lead to what seems like a good decision now turning into a bad one in the future.

3.5 A state based scheme needs an exit strategy

Federal climate change policy as currently configured appears insufficient to meet Australia's 2030 emissions reduction target – let alone any revision of that target. Additionally, the existing federal LRET is due to reach its conclusion by 2020, after which there will be no government policy aimed at reducing emissions in the electricity sector.

It is likely that the federal climate change policy review in 2017 will deliver a credible policy pathway to meet the 2030 emissions reduction target, most likely based on the current Direct Action policy. Any new policy - such as an intensity baseline scheme for the electricity sector – has the potential to supersede a state-based renewable energy auction scheme as an emissions reduction policy.

The Victorian government should consider an exit mechanism to cover the auction scheme in the event of such a federal policy outcome. In this case, it may be that the Victorian Government retains the option to cancel future auctions in the event of a compelling federal policy but will guarantee the agreed financial viability of projects already contracted up to that time. A specific arrangement is impossible to define as a lot will depend on what

type of scheme is introduced the Federal Government.

4 Addressing the consultation paper

4.1 Further work is required

The introduction of a subsidy scheme for large-scale renewable energy project in Victoria, to be paid by Victorian electricity consumers will have direct and indirect impacts on the operation of the NEM and the reliability and cost of electricity supply. These issues do not appear to have been fully considered by the consultation paper.

The core proposal is for the Victorian Government to provide a firmer, and possibly longer term, revenue stream to make projects commercially viable that would otherwise not have been commercially viable under LRET or at least not in Victoria. There seems to have been little consideration of the consequences for the Victorian Government, electricity consumers or the NEM that will arise from this risk re-allocation.

Utility-scale renewable energy projects face issues associated with transmission connection. Connections where transmission capacity does not need augmentation, planning for congestion issue, transmission augmentation and the question of scale efficient network extensions do not appear to have been fully considered in the consultation paper.

4.2 Do not proceed with the 2025 target

There could be a rationale for the Victorian Government to provide renewable policies to 2020 in order meet the national target. Without some form of government backing – although not

necessarily from Victoria – the 2020 LRET may not be met.

But trying to deliver policies for a 2025 target has two major issues. First, there is no understanding of what national policies will be in place post-2020. Second, there has not been enough consideration of the impact that a 40 per cent renewable target will have on the Victorian and national energy markets. It appears negligent to commit to policies without understanding the consequences of those policies. At the least, the Victorian Government should not proceed with their 2025 plan until this work has been undertaken.

4.3 Adopt capital grants to meet the 2020 target

The issues outlined in the consultation paper indicate that the government is struggling to find an appropriate trade-off between providing certainty to renewables projects and their financiers and increasing government – and the Victorian public's – exposure to risk in the market.

This is a fundamental challenge of schemes such as these. Providing the certainty needed for projects means increasing the risk for the government – which may eventually lead to increased costs for Victorian consumers. Trying to reduce this risk will be counterproductive and could lead to the targets not being met.

A conceivable way the government could achieve this outcome would be to provide capital grants to projects. Projects would bid to provide capacity on a \$ per megawatt basis. Those that can provide the capacity at the lowest cost will be provided the necessary capital to get their projects up and running. The project proponents are then left with the task of managing both the

wholesale market and certificate market risk as part of their commercial enterprise.

Of course, the Victorian Government will still need to determine how the cost of this approach will be met, either on budget or through the electricity bills of all Victorian consumers.

4.4 Conclusion

In our view answering the specific questions in the consultation paper is unlikely to address the central issues. Proceeding with the scheme should not be a consideration. The government has four choices:

- it can consult comprehensively with AEMO to fully assess the issues raised in this submission and develop proposed solutions before seeking further input from stakeholders
- It could undertake a comprehensive assessment of the proposed scheme with full consultation with key stakeholders to develop a more considered proposal
- It could put the proposal aside and engage with the Commonwealth in the spirit of the recent COAG Energy Council to develop a truly national approach to climate change policies that will meet Australia's emission reduction targets, deliver a lowest cost, low-emission energy future, including renewables. This will include a comprehensive review of energy only, gross pool wholesale market structure.
- It could apply a capital grant program to meet the 2020

target, recognising that there may be some additional costs imposed on Victorian consumers or taxpayers. The 2025 target should be put aside and one of the other three options adopted.

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