AUSTRALIAN INDUSTRY GREENHOUSE NETWORK

14th April 2011

Committee Secretary
Select Committee on the Scrutiny of New Taxes
PO Box 6100
Parliament House
Canberra ACT 2600

To whom it may concern,

Select Committee on the Scrutiny of New Taxes

The Australian Industry Greenhouse Network welcomes the opportunity to contribute to the Senate Select Committee on New Taxes – specifically in the context of its interest in a carbon tax and mechanisms to put a price on carbon.

AIGN is a network of Australian industry associations and businesses that have a serious stake in climate change issues and policies, and related energy policies. AIGN's membership represents companies that produce nearly all the energy in Australia, use nearly all the energy in the mining and manufacturing sectors of the economy, and are important to energy use in transport. AIGN members therefore account for a large percentage of emissions produced in Australia, although when measured on the basis of consumption, households are the largest emitting sector in Australia. AIGN members are also prominent in the development of forestry sinks.

A list of AIGN members is in Attachment A.

AIGN has made a number of representations to the Prime Minister in her capacity as the Chair of the Multi-Party Climate Change Committee outlining the views of the network with respect to a price on carbon. These letters substantively contain AIGN's answers to the questions posed by the Senate Select Committee's Terms of reference and they are attached to form AIGN's submission to the Inquiry.

Yours sincerely

Michael Hitchens
Chief Executive Officer

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ATTACHMENT A: AIGN MEMBERSHIP

Industry Association Members

Australian Aluminium Council
Australian Coal Association
Australian Food and Grocery Council
Australian Industry Group
Australian Institute of Petroleum
Australian Petroleum Production and Exploration Association
Australian Plantation Products and Paper Industry Council
Cement Industry Federation
Federal Chamber of Automotive Industries
Minerals Council of Australia
National Generator's Forum
Plastics and Chemicals Industries Association

Individual Business Members

Alcoa World Alumina - Australia
Adelaide Brighton Cement
BlueScope Steel Limited
BP Australia Limited
Caltex Australia
Cement Australia Pty Ltd
Chevron Australia Pty Ltd
CSR Limited
ExxonMobil Australia Limited
Hydro Aluminium Kurri Kurri Pty Ltd
Incitec Pivot Ltd
International Power Australia
Inpex Browse Ltd
Leighton Holdings Ltd
Origin Energy Limited
Qenos Pty Ltd
Rio Tinto Australia Limited
Santos Limited
Shell Australia Limited
Tarong Energy Corporation Limited
Thiess Pty Ltd
Tomago Aluminium Company Pty Ltd
Wesfarmers Limited
Woodside Petroleum Limited
Xstrata Coal Australia Pty Ltd

2 November 2010

The Hon Julia Gillard MP
Prime Minister
Parliament House
Canberra ACT 2600

AUSTRALIAN INDUSTRY GREENHOUSE NETWORK

Dear Prime Minister

Implementing a Carbon Price in Australia

I am writing to you in your capacity as Chair of the Multi-Party Climate Change Committee to bring to your attention AIGN's views on the implementation of a carbon price in Australia. I have written in similar terms to all other members of the Committee.

AIGN

AIGN is a network of Australian industry associations and businesses that have a serious stake in climate change issues and policies, and related energy policies. AIGN's membership represents companies that produce nearly all the energy in Australia, use nearly all the energy in the mining and manufacturing sectors of the economy, and are important to energy use in transport. AIGN members therefore account for a large percentage of emissions produced in Australia, although when measured on the basis of consumption, households are the largest emitting sector in Australia. AIGN members are also prominent in the development of forestry sinks.

A list of AIGN members is in Attachment A.

Rationale for a carbon price

Greenhouse gas mitigation policy represents one of the most important economic reform challenges Australian governments face. Done well, it can create the incentive for the growth of new economically sustainable industries without unnecessarily damaging the industries that have been responsible for very significant wealth creation over the last several decades, and in the last ten years been central to shielding us all from the worst impacts of the Asian financial crisis, the dot com bust and the GFC. Done badly, it will impose significant costs on all Australians with no better environmental outcome in terms of mitigating climate change.

What is needed is the application of an economic precautionary principle — capture the benefits of investment in new industries while not risking premature, and potentially unnecessary, loss of existing industry strengths.

AIGN's long-standing climate change policy principles (see Attachment B) establish a sound framework for progressing this important economic reform. At the heart of those principles is support for a mechanism that would establish a long-term emission price signal across the whole economy.

Important for achieving least-cost reform, establishing the long-term price signal must be accompanied by strong discipline on a range of implementation issues. In particular, the

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cost of reform will be high if governments create multiple emission or emission proxy markets with multiple prices signals, including through renewable energy and energy efficiency market mechanisms.

Complementary measures

A key challenge for the implementation of a single economy-wide carbon price is the concurrent removal of the vast majority of the other measures adopted by all governments that send conflicting and cumulative direct or shadow price signals.

AIGN is concerned that the terms of reference for the Multi-Party Committee treats the carbon price as complementary to other measures. If Australia is looking for a least cost outcome, and the Government has confirmed that this is its objective, then the reverse is the case.

Around ten years or so ago the Ministerial Council on Energy identified over 100 energy efficiency and climate change measures put in place by Federal and State governments. In 2007, the Wilkins review identified over 200 and now the Report of the Prime Minister's Task Group on Energy Efficiency suggests the number has grown to perhaps 300 – the Report itself recommends around another 40 or so policy measures.

Some of these measures are today costing households, and import and export competing industry, up to $600/tCO_2$. The tests for retaining any of these measures, best carried out by the Productivity Commission, is that the market failure the measure is directed at is not influenced by a carbon price and that the price at which the measure delivers emission reduction is no higher than the carbon price.

Industry cannot support the implementation of another new carbon price signal without tangible evidence that these economically inefficient, environmentally ineffective and inequitable existing price signals are being removed. If a key argument in support of a carbon price is to provide a framework within which industry can manage the uncertainty of investing in long-term emission reduction projects, then that argument holds no water without the attendant economic reform discipline of removing the uncertainty created by all governments through most of these other measures, or indeed the potential, based on history, to add further measures to a complex policy area.

Governments' track record through COAG in this area is not good. It may be that punitive action needs to be taken through a reduced distribution of Grants Commission funds or GST revenues to States that fail to make the required reforms to existing programs or continue to adopt new ones.

Trade exposed industry

In a perfect world with a universal carbon price signal, the issue of implementing an Australian price signal that is trade neutral is irrelevant. However, that world is a long way off and, in the interim, there is no good economic reform case for deliberately imposing a cost competitiveness disadvantage on Australian import and export competing industry. Successive task forces, starting with the States National Emissions Trading Taskforce in 2004, have reaffirmed this conclusion.

The task for the Multi-party Committee then is to further the debate on delivery, eligibility, amount and duration of an offset to the trade distortion created by an

Australian carbon price. In this regard, the CPRS arrangements are a reasonable, but incomplete beginning.

It is little understood that the EITE program design under the CPRS is not comprehensive. In particular, the argument that the EITE program shielded trade exposed industry from the carbon price signal is misinformed. In the first place, the EITE program was designed to deliver emission offsets of around 125 million tonnes of CO_2-e, whereas the estimated emission exposure of trade exposed industry is nearer 190 million tonnes. Second, for those that were eligible for EITE assistance – and this was a minority of trade expose manufacturing and mining industry – the particulars of the scheme design ensured a price signal incentive to reduce emissions.

This misunderstanding led some to claim that the EITEs program was a subsidy, just like tariff protection. The key to tariff reform was that it was guaranteed to deliver economic benefits to nearly all Australians irrespective of what our trade competitors did – that is, it provided unilateral benefits. On the other hand, the environmental benefits Australians seek from a carbon price cannot be delivered unilaterally – rather, those benefits can only be captured with emission reductions worldwide, including by our trade competitors.

As Professor Garnaut has commented in relation to this matter "incentives to unilateral action are mostly negative."

Implementation of a carbon price will be most successful in terms of both its economic reform and environmental objectives if it is trade neutral.

Compensating coal-fired electricity generators

This major economic reform involves imposing costs on households, workers and shareholders in order to deliver a greater good. A relative few will directly benefit economically. The wealth of the Australian economy, the significant environmental benefits from this economic reform and the considerable revenues that will be generated, no matter what style of carbon price is implemented, mean that no one should be required to carry a disproportionate share of that cost burden.

This conclusion obviously applies in the case of low income earners.

AIGN argues, and successive design task forces over the last six years at Federal and State level have agreed, that it should also apply in the case of shareholders, and workers and their communities, involved with coal-fired electricity generation. A long-term carbon price will result in a significant and immediate write-down of the asset value of many of these generators. Additional to this equity argument are the implications this loss will have for energy security.

The amount of the asset value loss will be fully captured by the Government either in the form of carbon taxes or permit auction revenues collected from these generators. Delivering an equitable outcome and minimising the energy security risks need not be a drain on the budget.

The task for the Multi-party Committee is therefore to further the debate on delivery, eligibility and amount of the asset value loss compensation created by an Australian carbon price. In this regard, the CPRS arrangements are not adequate.

International Agreement

While the details, including the targets, of the next international agreement on greenhouse gas emission reduction are outside the remit of the Multi-Party Committee, it is important to remember that the appropriate response to climate change is a globally consistent approach, which would include a universal price signal for greenhouse gas emissions and offsets.

In AIGN's view, however, such an approach is not likely to emerge within the investment horizon of industry. Nevertheless, Australia should continue to seek the negotiation of economy-wide assigned amounts from all 'advanced' countries starting from 2013. Rules for graduating from 'least-developed' to 'advanced' should be transparent and, where possible, empirical (for example, a level of GDP/capita at least that of the Ukraine).

AIGN supports a global agreement that imposes on the Australian community costs, as measured by the expected impact on GDP or GNI, that are comparable to the costs expected to be borne by citizens in countries with similar wealth. AIGN cautions the Committee against the use of simplistic measures of shadow carbon prices as a credible means of measuring 'comparable effort'.

Within that international agreement, the Australian Government should support mechanisms, and mechanism design features, that promote:

- Minimisation of the international price of carbon for any given global emission budget
- Management of future emissions price uncertainty
- Neutrality in trade competitiveness
- Environmental integrity
- Non-compliance rules that are credible and enforceable in a way that emissions markets can predict (the treatment of countries under the Kyoto Protocol will be an important signal to the market).

The extent to which these outcomes are achieved in the international agreement should influence the implementation of a carbon price in Australia, including decisions on whether to expose Australia's scheme to international pricing schemes.

AIGN urges the Committee to expose its deliberations on implementing a carbon price in Australia to public debate. For its part, AIGN will continue its role of helping to inform that public debate.

Yours sincerely

Michael Hitchens
Chief Executive Officer

CLIMATE CHANGE POLICY PRINCIPLES

AUSTRALIAN INDUSTRY GREENHOUSE NETWORK

Australian Industry Greenhouse Network's position on climate change is informed by the following principles:

Australia should make an equitable contribution, in accordance with its differentiated responsibilities and respective capability[1], to global action to reduce greenhouse gas emissions and to adapt to impacts of climate change.

Australia should engage the international community in pursuing identified and beneficial environmental outcomes through greenhouse gas emissions reduction action which:

- allows for differentiated national approaches;
- promotes international cooperation;
- minimises the costs and distributes the burden equitably across the international community;
- is comprehensive in its coverage of countries, greenhouse gases, sources and sinks;
- recognises the economic and social circumstances and aspirations of all societies; and
- is underpinned by streamlined, efficient and effective administrative, reporting and compliance arrangements.

In this global context, Australia should develop a strategic national approach to responding to climate change which:

- is consistent with the principles of sustainable development;
- is consistent with other national policies including on economic growth, population growth, international trade, energy supply and demand, and environmental and social responsibility;
- takes a long term perspective;
- maintains the competitiveness of Australian export and import competing industries;
- distributes the cost burden equitably across the community;
- adopts a consultative approach to the development of new policies; and
- is consistent and effectively co-ordinated across all jurisdictions throughout Australia.

Australia's future greenhouse policy measures should:

- be consistent with the strategic national approach;
- be trade and investment neutral, in a way that does not expose Australian industry to costs its competitors do not face;
- not discriminate against new entrants to Australian industry nor disadvantage "early movers" in Australian industry who have previously implemented greenhouse gas abatement measures;
- take account of the differing sectoral circumstances;
- be based as far as is practicable on market measures;
- address all greenhouse gases;
- address all emission sources and sinks; and
- balance, in a cost-effective way, abatement and adaptation strategies – both of which should be based on sound science and risk management.

1. Australia's contribution to the global climate change effort as set out here reflects the principle in Article 3.1 of the United Nations Framework Convention on Climate Change. Differentiated responsibilities and respective capabilities could take account of such matters as a country's economic growth and structure, population growth, energy production and use etc.

December 2002

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AUSTRALIAN INDUSTRY GREENHOUSE NETWORK

9th February 2011

The Hon Julia Gillard MP
Prime Minister
Parliament House
Canberra ACT 2600

Dear Prime Minister

Principles To Guide Development of a Carbon Price Mechanism

The AIGN welcomes the release by the MPCCC on the 21st December 2010 of the Principles to Guide Development of a Carbon Price Mechanism.

You will recall that AIGN wrote to you at the beginning of November 2010 identifying AIGN's views on the implementation of a carbon price in Australia, and bringing AIGN's own long-standing climate change policy principles to your attention.

AIGN has taken this opportunity to consider the MPCCC's principles and offer the following brief contribution to your deliberations.

The principles

1. **Environmental effectiveness**: The mechanism should be capable of delivering reductions in carbon pollution that are informed by the climate science, to ensure that Australia contributes to the global mitigation task and to help transform our economy by driving investment and innovation in clean energy and low emissions technologies and processes.

   AIGN: This is related to the MPCCC's principles 6 and 11. The principle could be further expanded to state that the mechanism should be the pre-eminent driver for delivering the commitment that Australian makes under any global agreement. In the period before a comprehensive global agreement is in place, it should be designed to prevent leakage from Australian import and export competing industry.

2. **Economic efficiency**: A mechanism to price carbon should harness the most cost-effective pollution reduction options and facilitate informed and efficient investment decisions. It should also minimise costs of our pollution reduction to the economy as a whole and be consistent with Australia's broader economic reform agenda.

   AIGN: This is also related to the MPCCC's principle 6. To action this principle the mechanism must be comprehensive in its coverage of gases and sectors. It will also not be consistent with a robust reform agenda unless it replaces all other policies and programs across all

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jurisdictions that cannot deliver emission reductions at a price lower than the mechanism price. Further, unless the framework engenders investors, both in existing operations and in new projects, with confidence over a 'bankable' timeframe of 15 to 20 years, economic efficiency will be impaired.

3. **Budget neutrality**: The overall package of a carbon price mechanism and associated assistance measures should be budget-neutral. This does not preclude other measures to address climate change being funded from the Budget, consistent with the Government's fiscal strategy.

   AIGN: The package needs to be designed with more than a four year budget timeframe in mind and, as the CPRS White Paper decided, should not be used as a means of wealth transfer.

   A key budget neutrality failing of the CPRS was the over-compensation of households in the early years and the offset of the carbon price on transport fuels with fuel excise reductions. Treasury numbers suggest that households would have received 59% of permit value and been exposed to around 45% of permit costs in the budget period ending 2012-13. Further, looking beyond the budget period, AIGN estimates that there was at least $10 billion worth of permits retained by Treasury to 2020 under the CPRS proposals.

   Finally, the key area where it is shown that carbon pricing will not deliver the most efficient incentive is in investment in RD&D. It is important that the priorities of publically funded RD&D, which is funded from general revenue, reflect the importance of emission mitigation and climate change adaptation to the nation.

4. **Competitiveness of Australian industries**: The overall package of carbon price design and associated assistance measures should take appropriate account of impacts on the competitiveness of all Australian industries, having regard to carbon prices in other countries, while maintaining incentives to reduce pollution.

   AIGN: A major shortcoming of the CPRS was that it did not take full account of the impact on competitiveness for those industries that qualified for EITE and failed to allocate any permits for the majority of trade-exposed mining and manufacturing industry, including for the food and beverage product manufacturers and machinery and equipment manufacturers which together account for 35% of employment in manufacturing and are highly trade-exposed.

   AIGN estimates that trade-exposed industry accounted for about 45% of emissions in the CPRS and that the EITE program would have delivered less than 28% of the permits. Unless there is an improved design for all trade-exposed industry in a new pricing mechanism the Prime Minister's vision of "manufacturing more and exporting more and regaining comparative advantage" will not become a reality.

   Importantly, however, it should be understood that the design of the CPRS permit allocation scheme exposed industry to the full price incentive to invest in emission reduction projects and processes — there were no subsidies for trade-exposed industry in the CPRS.

   AIGN notes that the reference to 'carbon prices in other countries' needs to be specific to each trade-exposed good, be calculated as 'effective carbon prices' and be calculated for the countries that are the specific competitors or potential competitors for the good in question.

5. **Energy security**: Introduction of the carbon price should be accompanied by measures that are necessary for maintaining energy security.

   AIGN: It is important that the mechanism design fully restores confidence in investing in Australia's electricity supply. Burdening some investors with large asset value losses will fail this principle.

6. **Investment certainty**: A mechanism to price carbon should provide businesses with the confidence needed to undertake long-term investments in low emissions technology and infrastructure, which will reduce costs for households and businesses in the long-term. It should keep our industries at the forefront of the research, development and deployment of new clean technologies, attracting global investment flows and creating new jobs.

   AIGN: There is an inherent conflict between this MPCCC principle and principle 8. Unless principle 6 takes precedence over principle 8, the necessary mobilisation of private capital will not take place in a way that delivers a least-cost outcome for the economy.

   Governments must learn from the mistakes made with the design of the MRET/RET and associated subsidies including feed-in tariffs for renewable generation across jurisdictions — a repeat of the constant direct and indirect interference by jurisdictions in the pricing mechanism must be avoided at all costs. The framework needs to meet the confidence requirements over the 15 to 20 year bankable periods of major investment in new technology.

   Further, how well the mechanism meets the commitments under MPCCC principles 4 and 5 will be a key determinant for investment confidence in the trade-exposed sectors and the electricity supply sector.

7. **Fairness**: The introduction of a carbon price will affect Australian households and communities. Assistance should be provided to those households and communities most needing help to adjust to a carbon price, while striving to maintain incentives to change behaviour and reduce pollution.

   AIGN fully supports this principle.

8. **Flexibility**: Internationally, climate change policy is continuing to evolve. A mechanism to price carbon should be sufficiently flexible to respond to changing international circumstances, including improvements in international accounting rules, developments in climate change science, and tangible international action to deliver an effective global solution.

   AIGN: Transparent processes that allow investors to reasonably predict the actions of governments that influence the emissions price over time must accompany any flexibility built into the mechanism.

9. **Administrative simplicity**: A mechanism to price carbon should be designed with a view to minimising both compliance costs and implementation risks.

   AIGN: To clarify, it is the compliance costs and implementation risks to liable parties and consumers that must be minimised, not the costs and risks to government that, after all, controls the mechanism.

10. **Clear accountabilities**: A mechanism with transparent scheme rules and clear accountabilities will help promote business and community confidence in carbon pricing.

    AIGN agrees with this principle.

11. **Supports Australia's international objectives and obligations**: An effective global solution requires action from all major emitters to limit the global temperature rise to less than 2 degrees. A carbon price mechanism should support the goal of promoting international action to deliver an effective global solution, and be consistent with Australia's foreign policy and trade objectives.

    AIGN: As noted above, the mechanism should be the principal driver for delivering the emission reductions that Australian commits to under any global agreement. As Minister Combet pointed out late last year, Australia's share of any global commitment should be comparable with "the distributional economic impact of carbon pollution reductions" that are pledged by other countries. Under the Cancun Agreement, Australia's 5% pledge imposes an economic cost, as measured by reduced Gross National Product, on Australians that is 3 to 4 times greater than that imposed on Europeans and Americans by the pledges of their governments. Further, the major developing economies have not yet committed to substantially restrain their emissions or to nominate when their emissions might peak. Until these circumstance change significantly, there is no case for Australia to make a greater pledge.

I would be pleased to discuss these views with you in detail.

Yours sincerely

Michael Hitchens
Chief Executive Officer

AUSTRALIAN
INDUSTRY
GREENHOUSE
NETWORK

7 March 2011

The Hon. Julia Gillard MP
Prime Minister

Chair Multi-Party Climate Change Committee
PO Box 6022
House of Representatives

Parliament House
Canberra ACT 2600

Dear Prime Minister

Proposed architecture for a carbon price mechanism

The AIGN notes the release by the MPCCC on 24 February 2011 of the framework outlining the broad architecture for a carbon price mechanism.

You will recall that AIGN wrote to you in November 2010 stating our views on the implementation of a carbon price in Australia, and again on 9 February 2011 in relation to the MPCCC's agreed principles. I now take this opportunity to provide the MPCCC with feedback on the proposed architecture, noting that AIGN members account for over 90% of Australia's emissions in the mining, manufacturing and energy transformation sectors.

Start date

AIGN has always taken the view that the start date for an emissions pricing mechanism is not particularly important, provided that the detailed design is the 'right design'.

However, from a practical point of view, it is important to understand that for many companies that would become liable parties, up to 12 months may be needed before the relevant systems are in place. This means that all the detailed legislation, including regulations, need to be in place before those systems are designed and implemented.

Length of the fixed price period and transition arrangements

The pricing mechanism design must provide businesses with the confidence needed to undertake long-term investments in low emissions technology and infrastructure. Without it, the necessary mobilisation of hundreds of billions of dollars of private capital will not take place in a way that delivers a least-cost outcome for businesses and the economy.

Major investment in low emissions technology requires an institutional framework that is stable, transparent, and incorporates the ability for businesses to manage uncertainty over 15 to 20 year 'bankable' periods. The details of the framework so far released of an unknown fixed price, escalating at some rate, for perhaps 3 to 5 years,

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which 'could' be followed by a cap-and-trade scheme, fails the key objective set by the Government which was to providing institutional certainty.

Moreover, how well the mechanism deals with the issues of trade-exposed industry and the electricity sector will also be a significant determinant for investment confidence in the those industries, where much of the new investment needs to take place.

In addition, governments must learn from the mistakes made with the design of the renewable energy targets (RET) and associated subsidies including feed-in tariffs for renewable generation across jurisdictions — a repeat of the constant direct and indirect interference by Federal and State governments in a new emissions pricing mechanism must be avoided at all costs. The original cost to electricity consumers in 2011 for the old MRET scheme was expected to be around $200 million. That cost doubled for the original RET scheme and now the new LRET/SRES scheme is estimated to cost electricity consumers over $1,200 million in 2011. Without counting all the other subsidies to renewables, the LRET/SRES will cost Australians this year more than $100/tonne CO_2.

Whatever the emissions price design, a robust agreement, including funding penalties if necessary, must be struck with all the States for the phase out of existing programs and policies that impose an implicit emissions price, and for no new policies to be implemented. Again the key objective set by the Government to provide institutional certainty will not be met without such an agreement.

Coverage

AIGN believes that the mechanism has to deliver emission reductions at least-cost. To achieve this, the mechanism must be comprehensive in its coverage of gases and sectors.

Even in any fixed-price period, emissions offsets from bio-sequestration should be available to meet liabilities. Indeed, without such a provision, the Carbon Farming Initiative (CFI) is dead-in-the-water.

AIGN has already made a submission to the Government on the CFI recommending that it be delayed and incorporated into any new pricing mechanism. The submission also noted that, if there are agricultural activities whose emissions could now be measured as suggested in the CFI, then these activities needed to be included in the coverage of the pricing mechanism as liable activities – the arguments for exclusion under the old CPRS are now not valid.

International Linking

Least-cost also requires that those liable to pay the fixed price or acquit permits must have access to the lowest cost offsets, whether they be domestic or international. This important design feature is recognised in the Government's submission on the importance of market mechanisms dated 24 February 2011 to the UNFCCC. It is therefore surprising that the framework announced by the Prime Minister does not recognise international offsets.

Importantly, the inclusion of international offsets from the beginning of the scheme might be an answer to the uncertainty created by the proposed framework of a fixed price period transitioning to a cap-and-trade scheme. If international offsets are allowed and the international price is below the arbitrary fixed price selected by the legislation, then the fixed price becomes a ceiling. On the other hand, if the reverse is the case, then the fixed price becomes a floor. Either way there is more confidence in the transition from fixed prices to an international price in the transition to cap-and-trade.

Assistance and other matters to be determined

On the principle of competitiveness of Australian industries, the design needs to fully offset the disadvantage imposed on Australian trade-exposed industry until there is a commensurate price impacting on our competitors. This will be necessary not just to maintain growth through the existing manufacturing, mining and mineral processing industry drivers of the economy, but also for the growth of the new industries in low emission technology manufacture and adoption.

A major shortcoming of the CPRS was that it did not take full account of the impact on competitiveness for industry. AIGN estimates that trade-exposed industry accounted for about 45% of emissions in the CPRS, and that the EITE program would have covered less than 65% of those emissions, imposing a cost disadvantage on Australian industry of over $20 billion to 2020.

For Australian industry, the Government was proposing to recognise just 42 activities as being at risk from the emissions price, whereas the EU recognises 166. Further, those Australian industries qualifying for assistance remained exposed to significant costs. Assistance to trade-exposed industries is not a subsidy; it is a reflection that these industries are unable to pass on these costs.

One of the problems with the current debate is that there seems to be an assumption that existing jobs in the current high wealth mining and manufacturing trade-exposed industries have to be sacrificed for the jobs in the 'new' industries. Most countries have the foresight to aspire to growth in all these industries.

The Prime Minister recently set out a vision for Australia to be "manufacturing more and exporting more and regaining comparative advantage". How the price mechanism deals with all trade-exposed industry will determine the fate of that vision.

It is also important regarding this vision of Australia for the price mechanism to deliver on electricity security at a competitive price, a combination that has been a proven contributor to Australia's comparative trade advantage. In the past, major changes to energy systems have proceeded over periods of 50 years or so. A compressed and radical change to Australia's electricity supply will require transitional assistance to the industry.

It is important that the mechanism design fully restores confidence in investing in Australia's electricity supply. If some investors incur large losses at the hands of government, they will not be investing in new capacity and the new investors will be looking for higher risk weighted returns. The end result is higher electricity prices than are necessary.

In summary, the Multi-Party Committee and the Government are still a very long way from meeting the challenge of the Prime Minister's vision for Australian industry, existing and new, while at the same time placing a price on greenhouse gas emissions.

Yours sincerely

Michael Hitchens
Chief Executive Officer

(Note: AIGN makes all its submissions public)

8 April 2011

The Hon. Julia Gillard MP
Prime Minister
Chair Multi-Party Climate Change Committee
PO Box 6022
House of Representatives
Parliament House
Canberra ACT 2600

AUSTRALIAN INDUSTRY GREENHOUSE NETWORK

Dear Prime Minister,

Professor Garnaut's Papers

Professor Garnaut has released eight papers updating his views from the report he published in 2008. I take this opportunity to advise the Multi-Party Committee of AIGN's views on the key elements of three of those papers.

Carbon pricing and reducing Australia's emissions – paper 6

AIGN agrees with Professor Garnaut that it is Australia's interests to encourage global action on mitigation, since without global action there are no climate change environmental benefits to Australia. However, AIGN sees no evidence yet that should encourage Australia to move beyond its 5% of 2000 emissions in 2020 commitment.

In particular, neither of the twin Government requirements of "major developing economies committing to substantially restrain emissions" and "advanced economies take on commitments comparable to Australia's" are yet on the international horizon:

- the major developing economy pledges are subject to overriding economic growth and poverty reduction requirements, and are characterised as 'best endeavours'. Many are expressed in terms of a reduction in emissions intensity greater than business-as-usual. Some may be no better than business-as-usual. None of these countries has yet pledged, let alone committed to, when their emissions might peak,
- advanced economies, like the EU and the USA, have pledges far less stringent than Australia's 5% pledge when measured against the criteria of an equitable "distributional economic impact"[1] amongst countries. Treasury modelling undertaken for the Government shows that Australia's 5% pledge would result in Australians paying in lost national income three to four times more than the Europeans and the Americans by 2020. Similar modelling by Access Economics for AIGN found that the 5% pledge would be asking Australians to pay US$785 per capita per year by 2020. On the other hand, Americans would be paying

[1] Minister Combet, address to Investor Group on Climate Change – "Driving the economy in a carbon constrained world" – 17 December 2010.

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around US$350 per capita and the Europeans just US$185 each in lost national income for the same environmental outcome.

Nevertheless, AIGN supports Professor Garnaut's conclusion that it is in Australia's interests to play its part through domestic policies that minimise the costs to all Australians which, in turn, requires a price on emissions that, from day one, is:

- economy-wide covering all gases and sectors
- the principal driver of emissions reductions and replaces all existing policies and programs that cannot deliver reductions at a lower cost
- reflective of the international price through a mechanism that allows the purchase of international credits.

In its letter of 7 March 2011 to the MPCCC, AIGN has already made its views known to you about the inadequacy of, and additional investment uncertainty created by, the hybrid price/trading framework announced by the Committee. Professor Garnaut's proposals add to that investment uncertainty.

Professor Garnaut's recommendations for trade-exposed industry transitional assistance are impractical, would add to the already unacceptable uncertainty created by the proposed hybrid framework itself and, in their proposed implementation, are not faithful to the 'principle':

- Professor Garnaut's so-called 'principled approach' for trade-exposed industry to apply from perhaps 2015 rests on the unlikely assumption that all Australia's trade competitors are moving toward pricing greenhouse gas emissions
- having defined the 'principle' of using the expected uplift in the traded price of a good as the assistance benchmark, Professor Garnaut then discards it with three arbitrary implementation rules that
  - limit assistance to those with an expected price uplift of at least 3%
  - impose a punitive limitation of the amount of assistance to less than the expected uplift (in the case example given in Professor Garnaut's original report, the assistance would be set at just 2/3rds the assistance called for under the 'principle')
  - cap the uplift to no-more than 100% of the emissions of the firm, whereas the 'principle' would demand more than 100% assistance because these firms are the ones expected to increase their trade share under a global price
- the proposition that an independent institution could possibly estimate the uplift price of all traded goods in any compliance period and the expected prices under a global emission price is fanciful. While the Productivity Commission work is important, it is clear from its methodology paper that the task would be costly and, in the end, arbitrary because of all the assumptions that would go to make up such calculations. Put simply, the recommendation is impractical
- how the transition from the approach of the CPRS to the Garnaut approach, with the array of different eligibility criteria and allocation formula, would be achieved is left unanswered. Unless those answers are known at the time the emissions price scheme is put in place, the uncertainty created for trade-exposed industry will stifle all investment, including investment in emission reduction.

In relation to how the tax revenue or permit value should be allocated within the economy, AIGN supports the CPRS White Paper principle, which we assume remains the Government's policy, that the allocation mechanism should not be used as a means to redistribute wealth in the economy. Following this principle, allocation becomes relatively straightforward and should be uncontentious:

- Treasury modelling shows that, assuming the same coverage of sectors as the CPRS and excluding offsetting excise rebates for transport fuels, low and middle income households can be fully compensated with about 45% of the tax revenue or permit value
- trade-exposed mining and manufacturing industry, that by definition cannot pass on costs to consumers (and this is also supported by the Treasury modelling of the impact on the CPI), account for around 45% of the revenue/permit cost and should receive that level of compensation until their global competitors take on these costs
- the remaining 10% of the revenue/permit cost is available to compensate for asset value loss (a reflection that not all the costs could be passed onto electricity consumers) in coal-fired electricity generation.

AIGN is concerned that the MPCCC is being given advice that a dollar allocated to industry is a dollar taken away from households. The above formulation clearly shows that this need not be the case, unless of course a decision is made to over-compensate households as was the case under the CPRS.

Low emissions technology innovation challenge – paper 7

AIGN broadly supports Professor Garnaut's direction on innovation. That is, that Australia should play its part in the global effort by looking for its own niches by:

- in basic research, focusing on areas where we have comparative advantage in research capacity and strong national interest in application
- in commercialisation, following business priorities backed by investment commitments
- reducing other costs of innovation by expanding relevant high-level education, and removing regulatory and legal barriers to new activities.

However, AIGN is not convinced of either the nomination of the arbitrary value of $2-3 billion or the institutional arrangements proposed.

In AIGN's view, the Government's funding for innovation both in mitigation and in adaptation should be subject to the same rigours as other innovation funding. It is understood that all government funding of innovation is currently around $9 billion per annum. The first question AIGN would ask is whether emission mitigation and climate adaptation is properly reflected in the priorities the Government sets for the institutions that currently receive that funding?

AIGN is also concerned that there have been large sums of money allocated to various climate change mitigation innovation programs over the last 10 years, and that there have been significant shortfalls in the spending of those funds. AIGN does not necessarily regard this as a bad outcome, but rather it suggests that the funding mechanisms themselves are not appropriate and/or that the innovation targets where misplaced. Either way, better programs, and perhaps institutions, need to be designed with broad industry input before budgets are assigned.

Transforming the electricity sector – paper 8

AIGN notes that Professor Garnaut's analysis of Australia's electricity distribution and transmission sector, and its regulation, has little to do with the question of greenhouse gas emissions pricing policy. AIGN also notes that there are numerous experts in this field, many of them regulators, with greater experience and understanding of the issues, and that the institutional arrangements are already in place to tackle the issues Professor Garnaut raises.

It is well accepted that secure energy supply at competitive prices has been a key driver of Australia's comparative trade advantage in mining and manufacturing. In the past, major changes to energy systems have proceeded over periods of 50 years or so. A compressed and radical change to Australia's electricity supply will require transitional assistance to the industry.

It is important that the emission price mechanism design fully restores investor confidence in Australia's electricity supply. If some investors incur large losses at the hands of government, they will not be investing in new capacity and the new investors taking their place will be looking for higher risk weighted returns. The end result is higher electricity prices than are necessary.

Should you need clarification of any of the issues raised in this letter please do not hesitate to contact me.

Yours sincerely

Michael Hitchens
Chief Executive Officer

(Note: AIGN makes all its submissions public)