MINERALS COUNCIL OF AUSTRALIA

A NEW CARBON PRICING SCHEME

MAY 2011

Minerals Council of Australia

The Minerals Council of Australia represents Australia's exploration, mining and minerals processing industry, nationally and internationally, in its contribution to sustainable development and society. MCA member companies produce more than 85 per cent of Australia's annual mineral output. The MCA's strategic objective is to advocate public policy and operational practice for a world class industry that is safe, profitable, innovative, environmentally responsible and attuned to community needs and expectations.

Table of Contents

Summary Points. 4

The importance of an integrated approach. 10

International action is weak, and where action is underway, carbon pricing has been phased in. 11

Australia is not lagging international efforts. 16

A CPRS-style approach to trade exposed sectors will damage exports, cost jobs, and reduce investment. 19

A CPRS-style scheme will fail Multi-Party Committee Principles. 24

Flaws in the proposed architecture will increase investment uncertainty. 25

A new approach is necessary to prevent loss of export competitiveness. 29

Summary Points

An integrated policy approach is necessary.

- An Australian carbon pricing scheme will be effective **only** as part of an integrated policy approach which includes:
    - a global agreement that includes concerted and comparable action by all major emitters
    - a measured transition to carbon pricing, with cost burdens comparable with those facing our competitors, and
    - the development and deployment of low emissions technologies.

But international action is weak, and where action is underway, carbon pricing has been phased in to prevent carbon leakage.

- Many of Australia's leading trading partners – the USA, Canada and Japan – have rejected or postponed plans for carbon pricing schemes.
- Free (or virtually free) allocation of all permits is a common feature of carbon pricing schemes that are being implemented or planned around the world, including in the European Union, regional US schemes and Korea.

Australia is not lagging the rest of the world.

- Australian emissions have grown by just 3 per cent since 1990 despite recording the strongest economic and population growth amongst developed nations over this period.[1]
    - The emissions intensity of the economy has been reduced by 44 per cent since 1990, outperforming the EU and the USA.
- Unlike many other developed nations, Australia will meet its Kyoto targets.

[1] Department of Climate Change, National Greenhouse Gas Inventory: Accounting for the Kyoto Target, December quarter 2010, p.6.

There has been no serious consideration of alternate carbon pricing options.

- Despite a commitment that 'all carbon pricing options were on the table', the Government has refused to consider alternate approaches and simply reverted to a model based largely on the Carbon Pollution Reduction Scheme.

A re-run of the flawed CPRS is the wrong approach.

- A CPRS-style approach to the treatment of trade exposed sectors will put Australia's export and import competing sectors at a severe competitive disadvantage.

    - Most of Australia's key competitors have no plans to adopt comparable carbon pricing and proposed transitional safeguards are vastly inferior to those adopted by the EU emissions trading scheme.

- The minerals sector faces combined carbon costs nearing $30 billion (in current dollars) over the period to 2020, threatening an investment pipeline worth $140 billion, and directly contradicting the Government's own strategy of 'maximising the opportunities of the Asian Century'.

    - On the Government's own modelling, output in key minerals sector will be slashed, while investment in coal mining will fall by 13 per cent.

    - The beneficiaries will be other nations - not a single Top 4 competitor/producer in any of 13 key minerals commodities has a functioning carbon pricing scheme.

- Treasury modelling also found that a CPRS-style scheme would produce 'up to 10 years' of 'temporary unemployment,'[2] a substantial contraction of investment in key export sectors, and 'reduce growth in aggregate productivity'.[3]

- A repeat of the flawed CPRS-style scheme will fail to meet the principles developed by the Multi Party Committee on Climate Change.

Uncertainty about the 2020 target means damaging uncertainty about future carbon prices.

- The hybrid approach, as proposed, will result in substantial volatility in carbon prices, and will compromise investment certainty.

A better way.

- A new approach is proposed to prevent loss of export competitiveness under carbon pricing.
    - Australia should follow other nations and adopt a phased approach to the introduction of auctioning of permits.
- All international schemes are based on a model where trade exposed sectors are safeguarded from carbon costs during a lengthy transitional period
    - In contrast, more than 80 per cent of Australia's merchandise exports will face the full brunt of carbon costs from the outset of the scheme.
- In the absence of a binding international agreement on greenhouse gas emission reductions, there should be a full or 94.5 per cent allocation of permits to trade exposed firms.
    - This allocation of permits would cover both Scope 1 (direct) and Scope 2 (indirect electricity, heat or steam) emissions.
- Under such an approach, all trade exposed sectors would be treated equally – there would be no arbitrary emissions intensity thresholds or complicated formulae for determining eligibility.

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[2] Australian Government, Australia's Low Pollution Future: the Economics of Climate Change Mitigation, October 2008, p.151.

[3] Ibid.

- Given the slow progress in global negotiations and to provide clarity and certainty for investors, the initial allocation should be fixed for 5 years, with an independent review conducted thereafter to assess progress made by other nations towards binding emission reduction commitments.
    - The auctioning of permits to trade exposed firms could be increased as trade competitor nations take on comparable commitments.
- This approach would be consistent with that adopted by the European Union Emissions Trading Scheme since 2005 as well as the approach proposed or being contemplated in Korea and in regional trading schemes in the United States.

Failing to deal with the trade exposure issue will mean that the environmental integrity of Australia's scheme will be compromised.

- The effect of the policy will not be a reduction in global emissions, but a simple reallocation of where those emissions take place.
- The costs borne by the Australian community will therefore have no environmental benefit.

Summary Points: 10 reasons why a CPRS-style carbon pricing scheme is the wrong approach.

1. **<u>Going it alone:</u> The proposed CPRS-style carbon pricing scheme is not linked with international developments**.

   Since June 2010, the United States, Canada and Japan have dumped or postponed carbon pricing schemes. Where action is underway, carbon pricing has been phased in to prevent carbon leakage. Global negotiations are stalled. Offers made by China and India as part of negotiations will see their emissions grow by 496 and 350 per cent by 2020 respectively (on 1990 levels). Meanwhile, an Australian carbon pricing scheme will raise as much as $11 billion p.a. from Australian businesses (and households) from 1 July 2012. None of our competitors will confront such costs.

2. **<u>Tax grab</u>: The scheme will generate carbon tax revenue of around $A523 per person in its first year. That compares with tax revenue generated by the European Union's emissions trading scheme of just $A0.96c p.a. since its commencement in 2005.**

   Since 2005 the European Union ETS has raised $A2.9 billion in tax revenue. A CPRS-style Australian scheme (assuming an opening carbon price of $25 per tonne CO_2) will raise more tax than that in its first 3 months alone. By 2020, the Australian scheme is projected to raise more tax ($150 billion in current dollars) than the annual GDP of 170 countries.

3. **<u>Jobs impact – national</u>: Treasury modelling projects that a CPRS-style scheme will slow national output resulting in 'up to 10 years' of 'temporary unemployment'.[4]**

[4] Australian Government, Australia's Low Pollution Future: the Economics of Climate Change Mitigation, October 2008, p.151.

According to Treasury modelling, '...as output slows slightly in response to emissions pricing, firms demand for labour also slows slightly. In the short run, real wages are assumed to be sticky, taking up to 10 years to adjust, resulting in some temporary unemployment.'[5]

4. **<u>Jobs impact – regional Australia</u>: Modelling prepared for State and Territory Governments shows that a CPRS-style scheme will reduce forecast employment by 126,000 by 2020.[6]**

The study found that 'rural areas, in general, are hit the hardest, followed by regional areas, with major urban areas around the country relatively less impacted.'[7]

5. **<u>Jobs impact – mining sector</u>: A CPRS-style scheme will reduce forecast employment in Australia's minerals sector by between 23,510 by 2020 and 66,400 by 2030.[8]**

The job losses will be felt in all States and the Northern Territory, with Queensland most affected losing 11,440 jobs, NSW shedding 4,260 jobs and WA losing 3,410 jobs by 2020.[9]

6. **<u>Exporters hit #1</u>: Only 0.1 per cent of Australia's exporters will receive assistance under the CPRS-style emissions intensive trade exposed program.**

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[5] Ibid.

[6] Access Economics, 'Report No.2: Impacts on Disadvantaged Regions', Report prepared for the Council for the Australian Federation Secretariat, May 2009, p.iii.

[7] Ibid, p.v.

[8] Concept Economics, 'The Employment Effects in the Australian Minerals Industry from the Proposed Carbon Pollution Reduction Scheme in Australia', Report prepared for the Minerals Council of Australia, May 2009.

[9] Ibid, p.27.

According to official data, 42,652 Australian firms exported goods to global markets in 2009-10.[10] Less than 60 firms have qualified for assistance under the Government's EITE program.

7. **<u>Exporters hit #2:</u> Firms that employ more than 950,000 Australians in manufacturing and mining – and whose products compete in global markets and on Australia's domestic market – will be exposed to the world's highest carbon costs from 1 July 2012.**

   The European Union will provide assistance to 164 industry sectors that generate 73 per cent of the EU exports. Under the CPRS Mark II, the Gillard Government will provide safeguard to about 60 Australian companies.

8. **<u>Discriminatory treatment</u>: A CPRS style scheme arbitrarily excludes Australia's most important export commodity – coal – from the transitional 'assistance program' developed for emissions intensive trade exposed (EITE) firms.**

   This is despite the fact that coal meets all the criteria applied to other industry sectors.

9. **<u>Lost output and investment</u>: The Government's own modelling shows that by 2020, a CPRS-style scheme will reduce coal mining output by 35 per cent, and investment by 13 per cent.[11]**

   This is consistent with independent analysis showing that it will reduce forecast output in key minerals sectors by between 12 and 41 per cent by 2020.[12]

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[10] Australian Bureau of Statistics, 'Characteristics of Australian exporters 2009-10', Category 5368.0.55.006, 30 March, 2011.

[11] See Australian Government, Australia's Low Pollution Future: the Economics of Climate Change Mitigation, October 2008, p.119 and p.152

[12] Concept Economics, <u>op cit</u>.

10. Lower productivity: The Government's own Treasury modelling forecasts that a CPRS-style scheme will 'reduce growth in aggregate productivity'.[13]

Government claims that its carbon pricing scheme will raise productivity are contradicted by Treasury analysis. According to the Treasury, 'emissions pricing shifts demand to low emissions, labour intensive sectors. These sectors typically have lower levels and growth of labour productivity, gradually reducing growth in labour productivity.'[14] (Emphasis added).

[13] Australian Government, Australia's Low Pollution Future, p.151

[14] Ibid.

1. Carbon pricing scheme is not part of an integrated policy approach.

An Australian carbon pricing scheme will be effective only as part of an integrated policy approach, including:

- a global agreement that includes concerted and comparable action by all major emitters
- a measured transition to carbon pricing, with cost burdens comparable with those facing our competitors, and
- the development and deployment of low emissions technologies.

- The development and implementation of these policy tools must be closely synchronized.

- If Australia moves too fast on carbon pricing without progress on a global protocol or technology solutions, the Australian economy will suffer and the environmental impact will be negligible, and possibly even negative.

- For example, a unilateral reduction in Australian emissions by 2020 by 160 million tones p.a. (to meet a 5 per cent reduction target) will impose real pain on the Australian economy but reduce global emissions by only 0.3 per cent.[15]

    - Under such a scenario, global emissions would fall from 57.2 Gt CO_2-e to 57.04Gt CO_2-e.

The three pillars are <u>not</u> aligned.

- The proposed carbon pricing scheme is **<u>not</u>** calibrated with the two other essential elements of an affordable and effective climate change policy.

[15] Treasury modelling projects global emissions (under the reference case) to reach 57.2 gigatonnes of CO_2-e by 2020. A 20 per cent cut on Australian emissions by 2020 would reduce global emissions from 57.2 Gt CO_2-e to 57.06Gt CO_2-e.

- The cost burdens imposed by proposed carbon tax are not comparable with, or linked to, actions by other major emitters, and take no account of the limited availability of low emissions technologies.

- The proposed scheme is **out of step** with schemes being developed around the world. It goes further and faster than any comparable scheme either in existence or being contemplated. It is the world's most aggressive carbon pricing scheme.

2. International action is weak, and where action is underway, carbon pricing has been phased in.

An Australian scheme must be calibrated with international developments.

A new carbon pricing scheme in Australia must take account of international trends in climate change policy action, including that:

- Free (or virtually free) allocation of all permits is a common feature of emissions trading schemes being implemented or planned around the world, including in the European Union, regional US schemes and Korea. (See table below).
- In the last 12 months, many of Australia's trading partners – the USA, Canada and Japan – have rejected or postponed plans for carbon pricing schemes.
- Developing nations' emissions are continuing to grow exponentially. China's Copenhagen 'offer' would see its CO_{2e} emissions rise by 496 per cent by 2020 (on 1990 levels),[16] while India's offer will allow its emissions to grow by 350 per cent by 2020 (on 1990 levels).[17]

Many claims about international action are exaggerated.

Claim #1: That Australia would only be catching up to the EU.

- The EU ETS is very different to a CPRS-style carbon pricing scheme. For the first 8 years of the EU scheme, virtually all permits were provided free to all firms covered by the scheme. From 2013, while auctioning will be introduced for the power sector, most industrial firms will receive a large allocation of free permits.
- Under the EU ETS, 164 industry sectors will be eligible for up to 100 per cent free permits from 2013 until 2020. Precise allocations will depend on benchmarks or grandfathering arrangements.

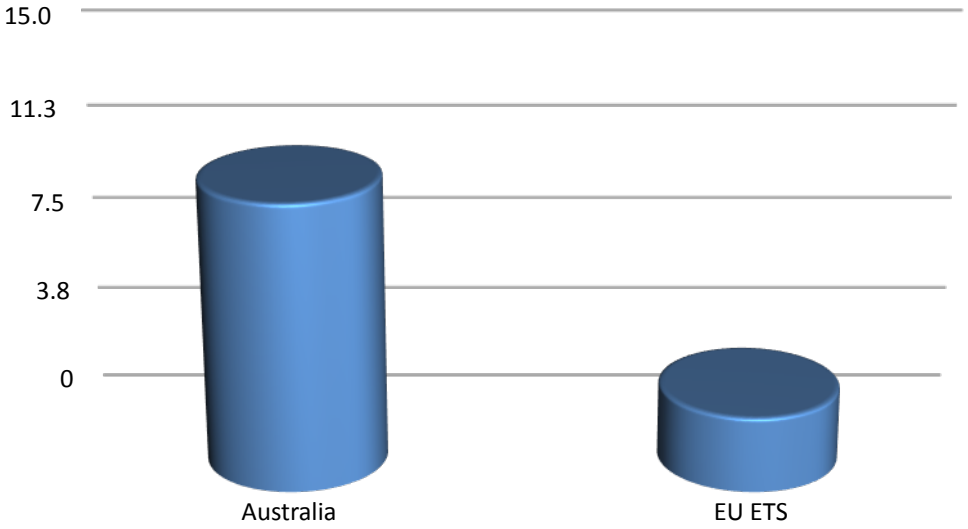
[16] Warwick J Kibbin, Adele Morris and Peter J Wilcoxen, 'Comparing Climate Commitments: A Model-based Analysis of the Copenhagen Accord', Discussion Paper 10-35. June 2010

[17] Ibid.

- Exempt sectors include all minerals and minerals production sectors as well as scores of sectors in which the EU competes directly with Australia.

- Even non-trade exposed industrial firms in the EU will receive 80 per cent of permits free in 2013, and will not be required to buy all their permits until 2027.

- The difference between the Australian and EU schemes is highlighted by the fact that the Australian scheme, if set at $25 per tonne, will raise more tax from liable Australian companies in its first 3 months than the European Union's emissions trading scheme has generated since its launch more than 6 years ago.[18]



Source: Official EU and academic estimates. Australian data assumes opening carbon price of Australian scheme at $25 per tonne of CO_2.

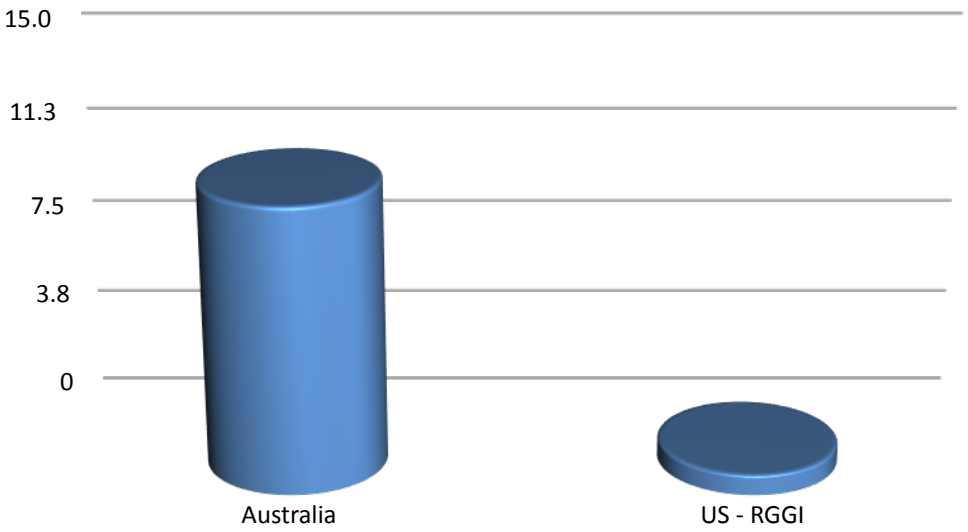
Claim #2: That a 10 state US regional scheme is ahead of Australian efforts.

- The Regional Greenhouse Gas Initiative – a regional emissions trading scheme in the covering power plants in 10 North Eastern states of the US – is routinely cited as an example of vigorous global action.

[18] We estimate that the EU ETS has generated $AUD2.63 bn in revenue since 2005. Phase 1 of the EU ETS (2005-07) included an auction of 2.7515 million permits at an average price of 26 Euros, raising a total of 71.5 million Euros. Further detail is available here. In Phase 2 (2008-12) of the scheme official EU data suggests that, as of March 2011, 89.2 million permits have been auctioned. At an average price of 20 Euros, this raises revenue of 1.78 billion Euros. At an exchange rate of $1AUD = 70 Euro cents, that suggests revenue of $A2.63 billion.

- Although the 10 states' GDP is three times the size of the Australian economy, the economic impact of the scheme is miniscule compared with that from a CPRS-style carbon pricing scheme.

- In particular, the proposed Australian carbon pricing scheme will raise more tax in its first month (July 2012) than the US regional scheme has generated since it started in January 2009. [19]



Source: RGGI and Australian estimates based on previous CPRS analysis. Australian data assumes opening carbon price of Australian scheme at $25 per tonne of CO_2.

Other sub-national trading schemes in North America are either encountering difficulties or proposing near universal issue of free permits (or both).

- the Western Climate Initiative is struggling. Only 4 or 5 of the original 11 states and provinces from western regions of US and Canada are likely to participate from 2012.

- The newly announced Californian scheme, known as AB-32, is characterised by the large scale distribution of free permits. Less than 10 per cent of allowances will be auctioned (compared with 70 per cent in the CPRS model) in the scheme's first three year compliance

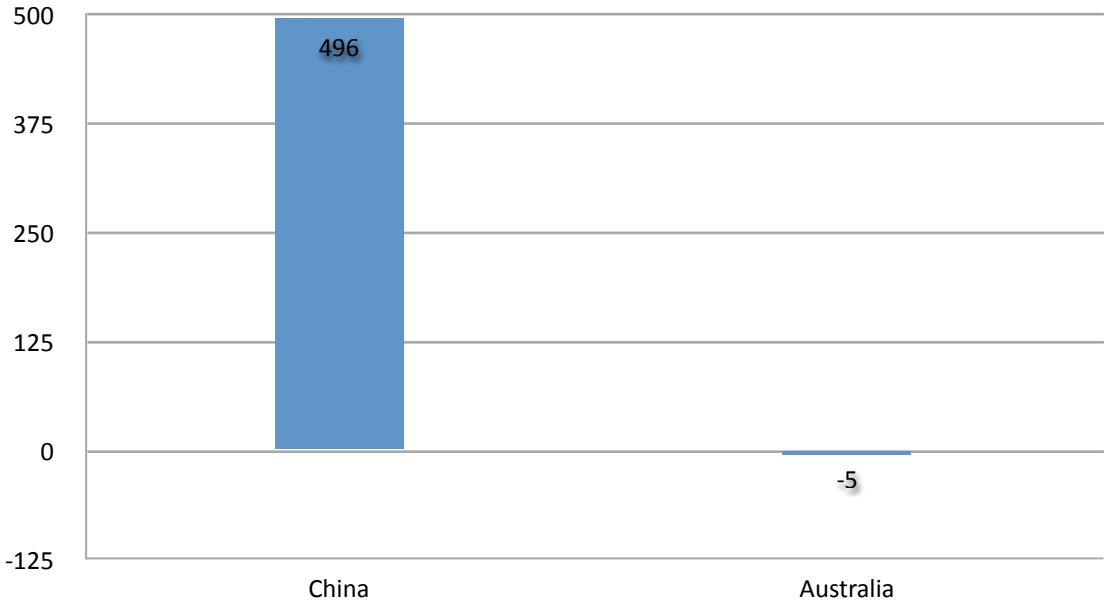
[19] Regional Greenhouse Gas Initiative, 'Report Highlights Benefits of RGGI CO_2 investments,' Press Release, 28 February, 2011.

period which begins in 2012.[20] This approach will 'minimise near-term costs to California consumers and businesses and minimise emissions leakage', according to the California Air Resources Board (CARB).

Claim #3: That China is outstripping Australian efforts…

In global climate talks, China has made a voluntary offer to reduce the emissions intensity of GDP (the tonnes of carbon emissions per dollar of economic output) by 40-45 per cent by 2020. Professor Warwick Kibbin, Adele Morris and Peter Wilcoxen for the Brookings Institution and Harvard University has analysed the impact of the 'offer' concluding as follows:

- China's Copenhagen 'offer' would see its CO_{2e} emissions **rise by 496 per cent** by 2020 (on 1990 levels).
- According to the Harvard Climate Project, taking account of the emission reductions offers contained in the Copenhagen Accord, Australia's average emissions intensity (per $ of GDP) in 2020 will be 0.31. China's will be 1.41 (4 times higher per $ of GDP) and India's will be 1.12 (nearly 3 times higher).



Source:

Claim #4 : That India is ahead of Australian efforts…

[20] For detail see California Air Resources Board, Rulemaking to consider the adoption of a proposed California Cap on Greenhouse Gas Emissions and market-based Compliance Mechanisms Regulation, including compliance offset protocols. Available at http://www.arb.ca.gov/regact/2010/capandtrade10/capandtrade10.htm

Reality: In global climate talks, India (4.8 per cent of global CO_{2e} emissions) has made a voluntary offer to reduce the emissions intensity of GDP by 20 to 25 per cent on 2005 levels by 2020. Analysis by McKibbin et al shows that:

- India's Copenhagen 'offer' would see its CO_{2e} emissions **rise by 350 per cent** by 2020 (on 1990 levels).

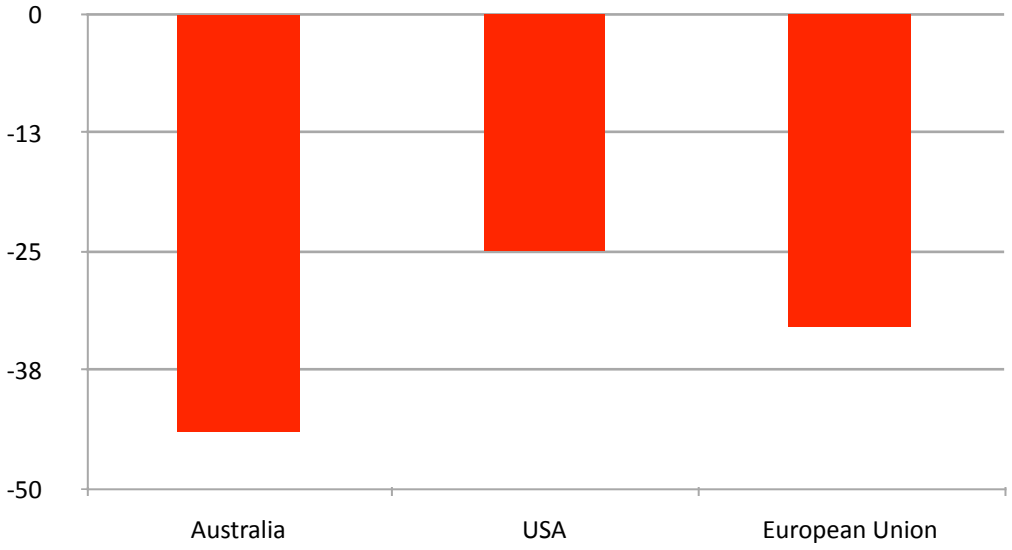
Out of Step: Maintaining Competitiveness in International Emissions Trading Schemes

Existing Scheme	Key elements	Status	Share of permits being allocated without charge.
European Union Emissions Trading Scheme (2005-12_	Limited coverage of sectors and greenhouse gases.		More than **98 per cent** of permits allocated in first two phases 2005 to 2012.
EU ETS (2013 onwards)	Phased introduction of auctioning. Methane (fugitive emissions from coal mining) still excluded.	Arrangements agreed in late December.	Trade exposed firms receive up to **100 per cent free permits**, depending on benchmarks and/or historic emissions. Non trade-exposed industry will receive **80 per cent of permits free in 2013**, and will not buy all their permits until 2027.
New Zealand	Limited coverage in initial phases. Scheme has no emissions cap.	A **review** of the NZ ETS is **underway** with a report due by end of 2011.	**Most permits allocated free.**
Regional Greenhouse Gas Initiative (USA)	Covers power plants in 10 Northeast States.	Emissions target for 2014 is 14 per cent **above** 2007 levels.	No permits allocated but **carbon price** is **very low** at $1.89.
Possible schemes			
Japan	Draft legislation for emissions trading scheme withdrawn.	**Postponed** until 2013 at earliest.	Early proposals envisioned **large share of free allocations**.
Korea	Plan to start scheme in 2013, with coverage of about 60 per cent of national emissions.	Parliamentary consideration **delayed.**	**90 to 95 per cent** of all permits allocated in first phase (2013 to 2015).
Western Climate Initiative (USA)	Original plan included 7 US states and 5 Canadian provinces.	Only 4 or 5 states or provinces likely to participate from 2012.	**All** permits allocated until 2015.
California AB-32	Cap and trade scheme with limited coverage. Aims to return California's emissions to 1990 levels by 2020.	First phase due to commence in 2012.	More than **90 per cent** of permits to be allocated.
Comparison with CPRS model			
Australia	All sectors covered except agriculture.	Framework announced. Govt has signalled it will be based on CPRS model.	**Only 25 to 30 per cent** of permits allocated.

3. Australia is not lagging international efforts.

Since 1990, Australia's carbon productivity has improved at a faster rate than many developed nations.

- Australia's economy has been improving its carbon productivity at a faster rate than many other nations over the last 2 decades.
- By the Kyoto Protocol's target period (2008 to 2012) Australia's greenhouse gas emissions per $billion of real Gross Domestic Product will have **declined by 44 per cent since 1990**.[21]
    - This far **outstrips the 31 per cent improvement in the European Union and 25 per cent in the United States**.[22]
- Under Australia's offer of a 5 per cent reduction in emissions by 2020, Australia's emission intensity will **fall by 45 per cent between 2005 and 2020**.[23]
- Australia's minerals sector has been a part of that steady improvement in emissions intensity. While coal production has increased by 93.4 per cent since 1990, fugitive emissions from coal production have increased by just 18.2 per cent over the same period.[24]



[21] Department of Climate Change, 2007: Tracking to the Kyoto and 2020, February 2008. p.15.

[22] See http://www.pewclimate.org/international/EU.

[23] Warwick J Kibbin, Adele Morris and Peter J Wilcoxen, 'Comparing Climate Commitments: A Model-based Analysis of the Copenhagen Accord', Discussion Paper 10-35. June 2010.

[24] Department of Climate Change, National Greenhouse Gas Inventory 2006: Accounting for the Kyoto Target, June 2008.

Australia is one of the few nations on target to meet Kyoto commitments.

Country	GHG Emissions change since 1990	Relationship to Kyoto target.
Australia	3 per cent increase	Well under target of emissions at 108 per cent of 1990 levels.
Canada	27 per cent increase	Will not meet Kyoto target (of 6 per cent reduction).
Japan	8 per cent increase	Well above Kyoto target of 6 per cent reduction.
New Zealand	26 per cent increase	Well short of Kyoto target of zero increase in emissions.
United States	16 per cent increase	Won't meet original Kyoto target (of 6 per cent fall).
EU-15	1.5 per cent decrease	EU confident that it will meet target of 8 per cent reduction.

- By 2020, under a 5 per cent reduction, Australia's average emissions intensity (per $ of GDP) will be **well below the global average** and broadly consistent with most developed nations.

Source: Harvard Climate Project (McKibben et al) 2010.

Per capita emissions (by production) is the wrong way to measure a nation's contribution to global emissions.

- In a globalised world, focusing on the production of emissions within national borders is the **wrong** way to measure a nation's contribution to global greenhouse gas emissions. This approach ignores the fact that 33 per cent of Australian emissions are embedded in exports.
    - Counting emissions on the basis of production rather than consumption **exaggerates** the contribution of exporting nations (like Australia) to global emissions, and **underestimates** the contribution of wealthier, service-based countries that actually consume those exports.

The emissions story changes substantially when based on consumption.

- Research by the Policy Exchange shows that when measured on a consumption basis, CO_2 emissions from EU-15 nations have **increased** by 47 per cent since 1990, compared with a reduction when calculated on a production basis.

- For the six largest EU member states, if emissions were counted on a consumption basis, the per capita tally would increase by more than 3 tonnes of CO_{2e} per person.[25]

- Separate work by the Carnegie Institution has found that around a quarter of global CO_2 emissions (6.2 gigatonnes CO_{2e}) are traded internationally.[26]

  - This work found that in a number of European countries – including Switzerland, Sweden, Austria, the United Kingdom and France – more than 30 per cent of consumption-based emissions were imported.

  - In these nations, these emissions were equivalent to more than 4 tonnes of CO_{2e} per person.

- According to this analysis, when emissions are counted on a per capita consumption basis, **Australia ranks below Singapore** and at a similar level to Canada and Belgium.

[25] Andrew Brinkley and Dr Simon Less, 'Carbon Omissions – Consumption-based accounting for international carbon emissions', Policy Exchange Research Note. October 2010

[26] Steven J Davis and Ken Caldeira, 'Consumption-based accounting of CO2 emissions,' www.pnas.org/cgi/doi/10.1073/pnas.0906974107.

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4. A CPRS-style approach to trade exposed sectors will damage exports, cost jobs, and reduce investment.

A CPRS-style carbon pricing scheme will damage the competitiveness of Australian exporters and import-competing industries.

- Arrangements to protect competitiveness of Australia's export sectors under a new carbon pricing scheme should <u>not</u> be based on the flawed CPRS approach.

    - If the CPRS approach is adopted, up to 84 per cent of Australian exports will enter global markets saddled with carbon costs not faced by international competitors.[27]

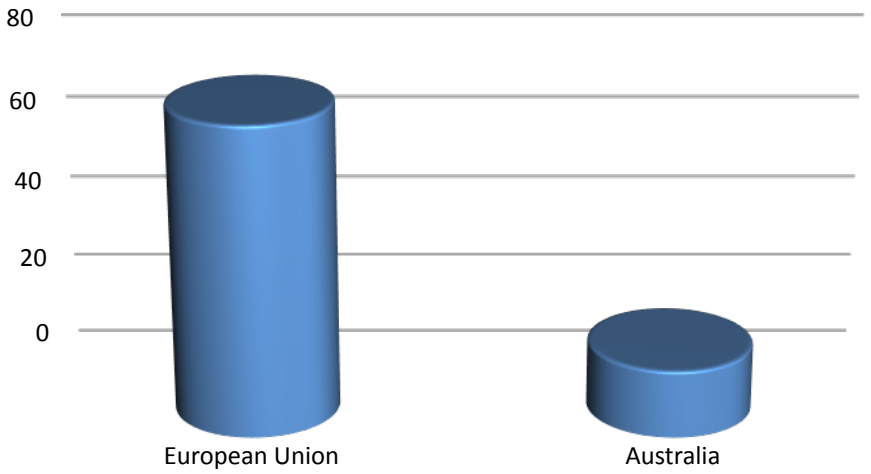
The CPRS approach compares poorly with arrangements agreed by the EU for its industry sector after 2013 when the EU begins to phase in carbon costs.

- Under the EU scheme, 73 per cent of European Union exports will receive up to 100 per cent free permits for their emissions.

    - In contrast, just 16 per cent of Australian exports receive transitional assistance under the CPRS EITE model.[28]

[27] SFS Economics, 'Criteria for identifying emissions intensive trade exposed industries: Comparison of the Australian and European Union approaches', Report prepared for the Minerals Council of Australia, March, 2011.

[28] Ibid.



Source: SFS Economics.

The minerals sector will face carbon costs nearing $30 billion by 2020.

- Only 10 per cent of minerals sector exports will receive transitional safeguards to protect their competitiveness.

In particular, the carbon costs for just 3 minerals commodities could exceed $25 billion over the period to 2020.

- Over the period 2012–21, the likely liability for the coal sector will be more than $18 billion.
    - If the 2020 target is more ambitious than 5 per cent (as the Greens insist) the coal sector's cumulative carbon costs will exceed $20 billion.
- An indicative cumulative carbon cost through to 2020 for the gold sector is more than $2 billion.
    - If a higher (15 per cent) target is embraced the cumulative carbon costs will surge to $3.3 billion.
- An indicative cumulative carbon cost through to 2020 for the nickel sector is $1.34 billion.
    - If a higher (15 per cent) target is embraced the cumulative carbon costs will surge to $2 billion.

Under a CPRS-style 'assistance' scheme for the coal sector, the sector will face $16.7 billion carbon costs by 2020.

- During CPRS Mark I, the then Rudd Government proposed a Coal Sector Adjustment Scheme.

- If such a proposal was repeated, Australia's coal sector would pay $16.7 billion in net carbon costs (today's dollars) by 2020-21, down marginally from $18 billion.

The Government's own modelling shows that by 2020, a CPRS-style scheme will reduce coal mining output by 35 per cent, and investment by 13 per cent.[29]

- These results are consistent with independent analysis showing that a CPRS-style scheme will reduce forecast employment in Australia's minerals sector by 23,510 by 2020 and 66,400 by 2030.[30]
- The job losses will be felt in all States and the Northern Territory, with Queensland most affected losing 11,440 jobs, NSW shedding 4,260 jobs and WA losing 3,410 jobs by 2020.[31]

The principal beneficiaries of the CPRS-style scheme will be Australia's competitors in global commodities markets.

- Most of Australia's competitors across major commodities are developing nations that have no plans to introduce a comparable carbon price (see table).
- Not a single Top 4 competitor/producer in any of the 13 key minerals commodities has a functioning carbon pricing scheme. (In the sole case of Poland, emissions from coal mining are exempted from the EU ETS).

AUSTRALIA'S COMPETITORS IN EXPORTS AND PRODUCTION OF KEY COMMODITIES*

Iron ore	Brazil	India	South Africa	Canada
Thermal coal	Indonesia	Russia	South Africa	Colombia
Met. coal	USA	Canada	Russia	Poland
Copper	Chile	Peru	Indonesia	Canada
Gold	China	USA	Russia	South Africa
Aluminium	China	Russia	Canada	USA
Nickel	Russia	Indonesia	Canada	Philippines

[29] See Australian Government, Australia's Low Pollution Future: the Economics of Climate Change Mitigation, October 2008, p.119 and p.152

[30] Concept Economics, 'The Employment Effects in the Australian Minerals Industry from the Proposed Carbon Pollution Reduction Scheme in Australia', Report prepared for the Minerals Council of Australia, May 2009.

[31] Ibid, p.27.

Zinc	China	Peru	USA	India
Lead	China	USA	Peru	Mexico
Manganese	China	South Africa	Kazakhstan	India
Silver	Peru	Mexico	China	Bolivia
Tin	China	Indonesia	Peru	Bolivia
Uranium	Kazakhstan	Canada	Namibia	Russia

Source: ABARES, Australian Commodity Statistics 2010.
*Data for Iron ore, coal and copper concentrate are based on 2009 export statistics.
Data for aluminium, nickel, zinc, lead, manganese, silver, tin and uranium is based on 2009 production statistics.
Nickel, zinc, lead, silver and tin are mine production statistics.
Data for gold is based on production and drawn from GFMS Gold Survey 2011.

Government claims that CPRS-style scheme is more generous than the EU ETS are wrong.

Analysis of the two schemes demonstrates that measures developed under the CPRS 'emissions intensive trade exposed' (EITE) program are **vastly inferior** to those developed for their European Union competitors under the EU ETS:

- **Tax burden**: Since its inception in 2005 the EU scheme has established a functioning carbon market without a tax spree. The CPRS Mark II represents a tax spree without a transition. The CPRS Mark II will raise more tax in its first three months than the EU scheme has generated since 2005.
- **Treatment of coal mining:** The EU scheme exempts fugitive emissions from coal mining. The CPRS Mark II will cost the Australian coal mining industry $18 billion (in current dollars) by 2020.
    - Not a single ounce of the 45 million tonnes of CO_{2e} emitted by the coal mining sector in Europe annually will incur a single Euro under the EU ETS until 2020 at the earliest.
- **Coverage of export sectors**: The EU scheme's trade exposed provisions apply to 164 sectors that account for 73 per cent of EU merchandise exports. The so-called EITE provisions of CPRS Mark II will cover just 40 'activities' – 84 per cent of Australia's goods exports will receive no assistance.
- **Safeguards for employment in manufacturing/mining**: The EU trade exposure provisions cover sectors that account for 50 per cent of employment in manufacturing and mining.

- Under a CPRS Mark II framework, sectors accounting for 90 per cent of total manufacturing employment in Australia – more than 900,000 employees – will receive **no transitional assistance** to safeguard their competitiveness.

- **Compensation for electricity costs**: Contrary to the Minister's assertions, European trade exposed firms will be compensated for both direct emissions costs and higher electricity charges.

    - Paragraph 31 of the relevant EU Directive states that 'sectors or sub-sectors deemed to be exposed to a significant risk of carbon leakage may be compensated for costs related to greenhouse gas emissions passed on in electricity prices by financial measures adopted in Member States in accordance with state aid rules applicable and to be adopted by the Commission in this area.

- **Limits on support**: The Minister claims that the EU limits support to a cap of 29 per cent of permits. This cap applies to direct emissions only, and there is **no** explicit limit on additional compensation for electricity price increases. Support for Australian firms (for both direct and indirect emissions) is estimated at 25 to 28 per cent. The Greens propose a cap of 20 per cent.

5. A CPRS-style scheme will fail MPCCC principles.

MPCCC principle	Consistency with principles
Environmental effectiveness	Fail. If the scheme weakens the trade competitiveness of Australia's export and import competing industries, then investment and market share could shift to less efficient producers abroad, resulting in an increase in global emissions.
Economic efficiency	Fail. The proposal to exclude international offsets (and possibly also domestic offsets) during the fixed price period will raise the cost of the scheme. Uncertainty about the
Budget neutrality	Jury out. It is clear, however, that the scheme model is an unnecessarily high taxing approach.
Competitiveness of Australian industries	Fail. If the new scheme is based on the CPRS model, the scheme will damage the competitiveness of a large share of Australian exports. The CPRS EITE measures cover just 16-19 per cent of exports. In contrast, the EU scheme covers 73 per cent of EU exports.
Energy security	Jury out. If the new scheme approach to transitional measure for power generators is based on the CPRS model, the scheme will fail this criterion.
Investment certainty	Fail. The decision not to set a 2020 target until mid 2014 or 2016 will have adverse consequences for investment certainty. There will be no clarity on likely carbon prices until a target and trajectory is agreed.
Fairness	Fail. The fairness test must apply to employees working in export and import-competing sectors. A scheme that compromises the competitiveness of exporters will cost thousands of jobs especially in regional Australia.
Flexibility	Fail. An approach based on the CPRS contains little flexibility for adjustment as other nations act (or fail to act).
Administrative simplicity	The hybrid approach, including an initial fixed price phase, has some advantages in providing a transition to a cap and trade model.

Clear accountabilities	Jury out. Much of the framework of the likely emissions trading scheme is uncontroversial. However, the absence of clarity on a 2020 target will not provide industry confidence on the medium term carbon price trajectory.
Supports international objectives and obligations	Capable of delivering Australia's Copenhagen offer, but potentially at great cost.

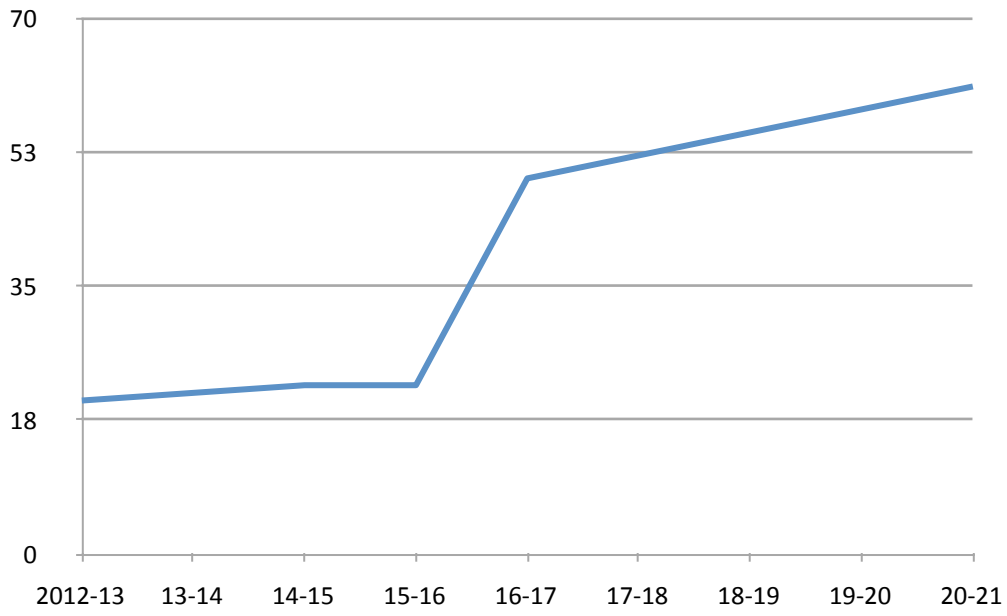
6. Flaws in the proposed framework will damage investment certainty and raise costs.

Uncertainty about 2020 targets means damaging uncertainty about future carbon prices.

- The proposed hybrid approach will result in substantial volatility in carbon prices, and will compromise investment certainty.
    - In particular, the decision not to set a 2020 target and forward trajectory until mid 2014, 2016 or even later will have adverse consequences for investment certainty.
- This reflects the fact that 2020 targets and trajectory will be critical in shaping the carbon prices after the fixed price phase ends.
    - But the lack of clarity on whether Australia will be taking on a 5, 15 or even 25 per cent emissions reduction target for 2020 (against 2000 levels) will create significant uncertainty about the level of the carbon price once the 'fixed' price phase ends.
- The scale of this uncertainty is highlighted by economic modelling by the Centre of International Economics which canvasses carbon price scenarios after a 4 year fixed price phase (the midpoint between a 3 or 5 year fixed price phase).

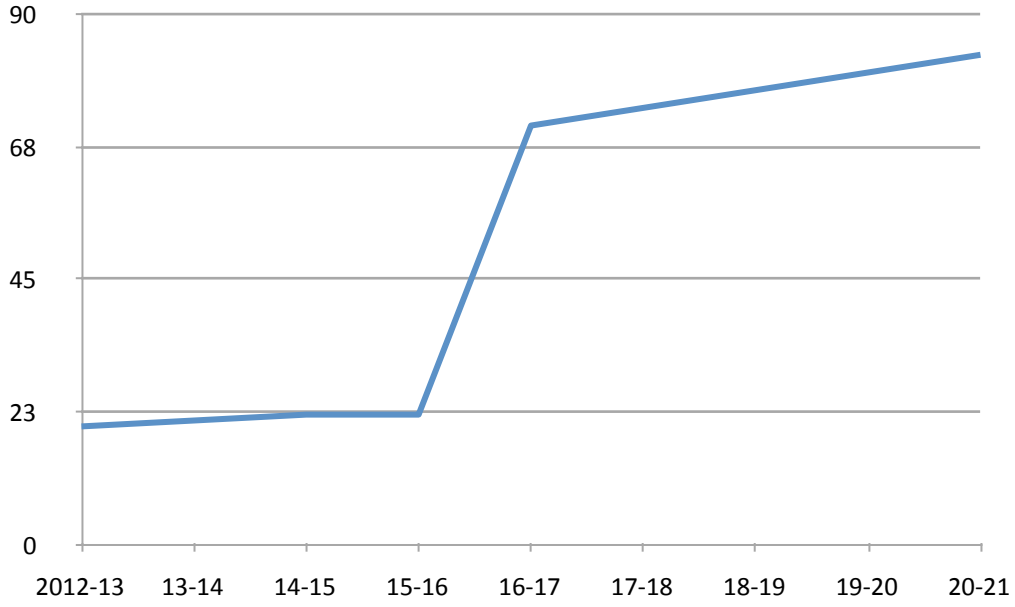
- The modelling shows that Australia's businesses will be uncertain whether they will face a $49 carbon price (on a 5 per cent target), a $71 carbon price (on a 15 per cent target) or even one close to $100 (on a 25 per cent reduction) once the fixed price phase ends.

On a minus 5 per cent 2020 target, the carbon price could reach $50 after the fixed price phase ends.

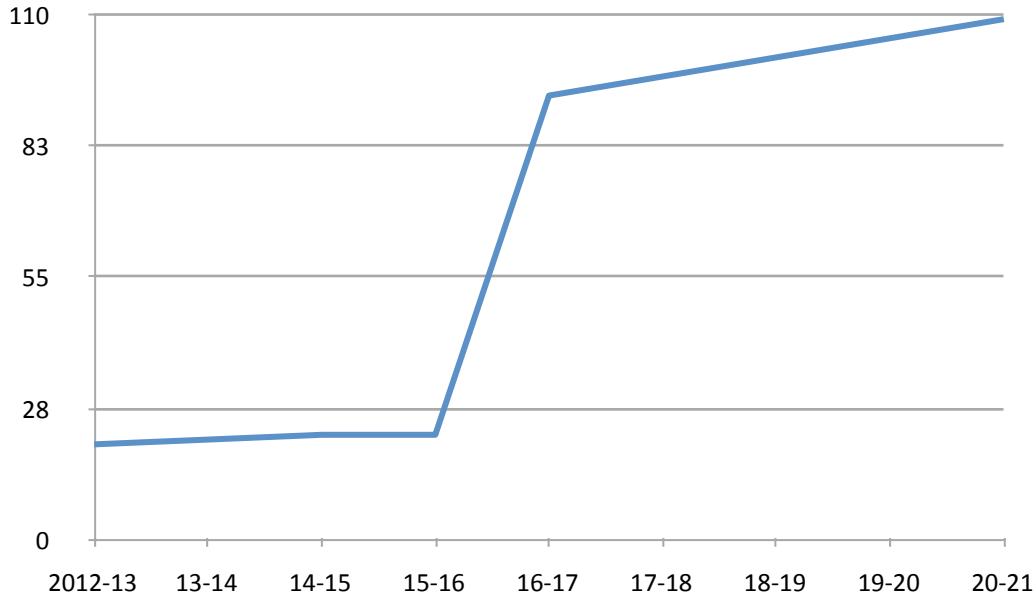


Centre of International Economics

On a minus 15 per cent 2020 target, the carbon price could reach $71 soon after the fixed price phase ends.



On a minus 25 per cent 2020 target, the carbon price could reach $93 soon after the fixed price phase ends.



The flaws will raise costs.

- Under the scheme design, a carbon tax will be in place until agreement can be reached on a 2020 target.

- The Gillard Government has signalled that international offsets will not be available under the fixed price phase which could extend until 2020.

- Analysis published by the Brookings Institution and the Harvard Climate Project has shown that in the absence of international trading, **Australia's GDP will fall by 6.3 per cent by 2020**. [32]

    - This would represent the sharpest adverse GDP impact on any developed or developing nation.

Source: McKibbin et al.

[32] Warwick J Kibbin, Adele Morris and Peter J Wilcoxen, 'Comparing Climate Commitments: A Model-based Analysis of the Copenhagen Accord', Discussion Paper 10-35. June 2010

7. A **new approach** can prevent the loss of export competitiveness, and achieve better environmental outcomes.

The CPRS-style approach proposed by the Government will have a substantial negative impact on output and employment in export and import-competing industries.

- Modelling prepared for State and Territory Governments shows that a CPRS-style carbon pricing scheme will reduce forecast employment by 126,000 by 2020,[33]with the most significant impact in regional and rural areas.
- Output and investment in the minerals sector will fall by between 12 and 41 per cent.
    - This will lead to a reduction of forecast employment in the minerals industry of 23,500 by 2020, increasing to 63,000 fewer jobs by 2030.[34]
- The Government's own Treasury modelling found that a CPRS-style scheme would produce 'up to 10 years' of 'temporary unemployment,'[35] a substantial contraction of investment in key export sectors, and 'reduce growth in aggregate productivity'.[36]

Any carbon pricing scheme adopted in Australia must effectively deal with trade exposed industries.

- It is a simple reality that most of Australia's trade competitors will not have a carbon price in place in the near future.

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[33] Access Economics, 'Report No.2: Impacts on Disadvantaged Regions', Report prepared for the Council for the Australian Federation Secretariat, May 2009, p.iii.

[34] Concept Economics, 'The Employment Effects in the Australian Minerals Industry from the Proposed Carbon Pollution Reduction Scheme in Australia', Report prepared for the Minerals Council of Australia, May 2009.

[35] Australian Government, Australia's Low Pollution Future: the Economics of Climate Change Mitigation, October 2008, p.151.

[36] Ibid.

- Australian industries will therefore be at a substantial competitive disadvantage.

Failing to deal with the trade exposure issue will mean that the environmental integrity of Australia's scheme will be compromised.

- The effect of the policy will not be a reduction in global emissions, but a reallocation of where those emissions take place.
- The costs borne by the Australian community will therefore have no environmental benefit.

A different approach is required to prevent loss of trade competitiveness under carbon pricing.

- An Australian carbon pricing scheme must not impose costs on trade exposed firms ahead of international competitors.
    - Australia should follow other nations and adopt a phased approach to the auctioning of permits.
- All international schemes (current or planned) are based on a model where virtually all permits are allocated without charge to the traded sector during a lengthy transitional period.
    - In contrast, more than 80 per cent of Australia's merchandise exports will face the full brunt of carbon costs from the outset of the scheme.
        - A CPRS-style EITE model will provide assistance to less than 60 Australian firms, out of 42 600 exporters and tens of thousands more domestic businesses that compete with imports.
- The CPRS EITE model is overly complex, based on subjective emissions intensity thresholds which fail to take account of a sector's trade exposure, and prone to political interference and horse-trading.
    - The CPRS approach arbitrarily excluded Australia's largest export sector (coal), despite the fact that it meets the stated criteria.

The scheme design must recognise that trade exposed firms cannot pass on carbon costs to customers.

- Trade exposed businesses operating in fiercely competitive global markets have no capacity to pass direct or indirect carbon costs on to their customers.

- A carbon pricing scheme that fails to include measures to fully preserve the international competitiveness of Australia's export and import-competing industry during a period of uneven or limited international action will cost jobs, investment and increase the cost of living of all Australians.

Allocation of permits to trade exposed industries is a simple and practical approach to dealing with the trade exposure issue.

- Complicated activity schemes and definitions are not necessary.
- In the absence of a binding international agreement on greenhouse gas emission reductions, there should be a full or 94.5 per cent allocation of permits to trade exposed firms. This allocation of permits would cover both Scope 1 (direct) and Scope 2 (indirect electricity, heat or steam) emissions.
    - Under such an approach, all trade exposed sectors would be treated equally – there would be no arbitrary emissions intensity thresholds or complicated formulae for determining eligibility.
- Given the slow progress in global negotiations and to provide clarity and certainty for investors, this allocation should be fixed for 5 years, with an independent review conducted thereafter to assess progress made by other nations towards binding emission reduction commitments.
    - The auctioning of permits to trade exposed firms could be increased as trade competitor nations take on comparable commitments.
- This approach would be consistent with that adopted by the European Union Emissions Trading Scheme since 2005 as well as the approach proposed or being contemplated in Korea and in regional trading schemes in the United States.

Treatment of fugitive emissions from coal mining should be consistent with international approaches.

- In addition to the phase-in arrangements the treatment of fugitive emissions under Australia's proposed carbon pricing mechanism must be in step with other international jurisdictions including the EU ETS (where fugitive emissions are excluded) and Australia's major coal export competitors (e.g. Indonesia, Russian Federation, South Africa, Colombia, Canada, USA and Mozambique), all of whom face similar difficulties associated with the measurement and mitigation of these emissions.

Appropriate safeguards for trade exposed firms will not reduce the ability of the scheme to achieve its medium term targets.

- Providing trade exposed firms with a full or 94.5 per cent allocation of permits will not reduce the environmental effectiveness of the proposed scheme. Allocating permits without charge will not make a scheme less environmentally rigorous than if all permits are auctioned.
- A long recognised and fundamental feature (and advantage) of emissions trading is that the approach to initial allocation does not affect the ultimate outcomes from the scheme[37].
- As the Pew Center on Global Climate Policy points out:

> It is important to remember that a comprehensive cap-and-trade program generally can achieve environmental and economic objectives regardless of how allowances are allocated. Because total emissions are capped the allocation of allowances does not affect the environmental integrity of the scheme.[38] (Emphasis added)

Trade exposed firms receiving allocated permits will have strong incentives to reduce emissions.

- Firms will face incentives from two directions. First, they have an incentive to seek out and implement lower emissions technologies in order to avoid permit costs in the future.
- Second, firms will have an incentive to implement lower emissions technologies in order to reduce emissions and so generate returns from selling permits into the market — in line with the principles of emissions trading.

Importantly, initial full allocation relieves a cash flow constraint on trade exposed firms.

- Given that trade exposed firms cannot pass on permit costs to consumers, initial full allocation will avoid cash flow issues and will ensure that firms retain funds to invest in lower emission technologies.

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[37] See, for example the seminal work of David Montgomery (1972) 'Markets in Licenses and Efficient Pollution Control Programs', Journal of Economic Theory, vol 5, pp395-418.

[38] Pew Center on Global Climate Change, Greenhouse Gas Emissions Allowance Allocation, Congressional Policy Brief, Fall 2008. See also the arguments in Peace and Stavins (2010) Meaningful and Cost Effective Climate Policy: The Case for Cap and Trade, Pew Centre on Global Climate Change, June.

The design of an Australian carbon pricing scheme faces a simple choice, either….

- Adopt a simple and effective allocation approach for trade exposed industries so as to maintain the environmental integrity of the scheme; **or**
- Deal ineffectively with the trade exposure problem and impose costs on the Australian community without necessarily achieving any environmental benefits.