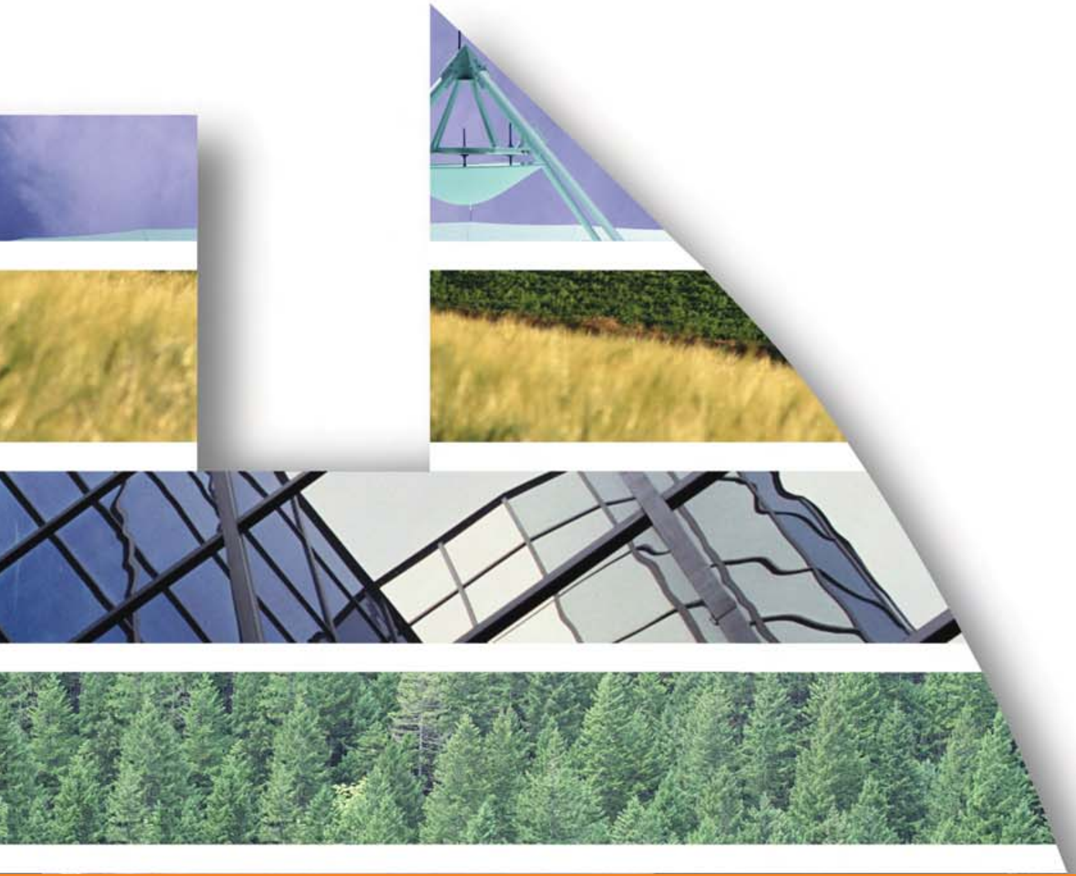

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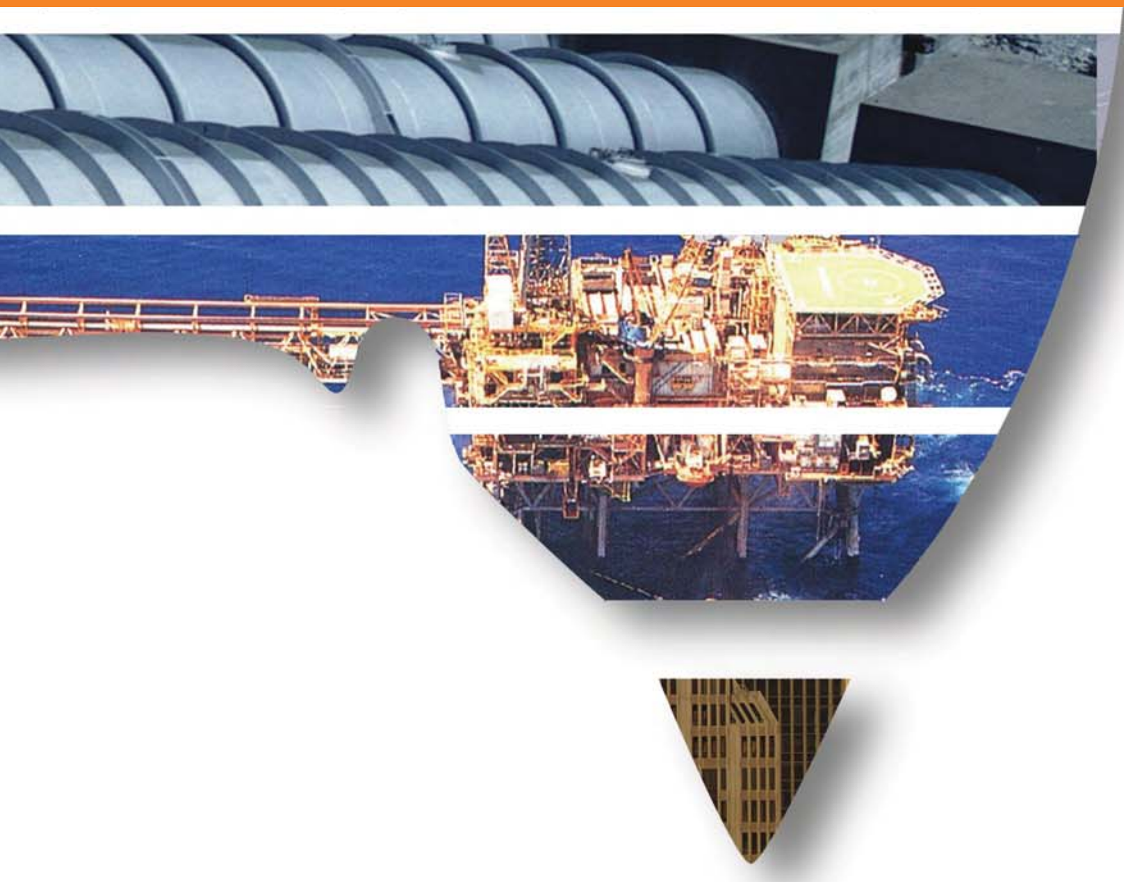
AIGN Submission to the Parliament's Joint Select Committee on the Clean Energy Future Legislation

September 22 2011



AIGN Submission to the Parliament's Joint Select Committee on the Clean Energy Future Legislation

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1 INTRODUCTION

The Australian Industry Greenhouse Network (AIGN) welcomes the opportunity to make a submission to the Joint Select Committee on the Clean Energy Future (CEF) legislation.

AIGN is a network of Australian industry associations and businesses that have a serious interest in climate change issues and policies. Its members account for over 90% of Australia's mining, manufacturing and energy transformation emissions. A list of AIGN member associations and corporations is at Attachment A.

The AIGN's members have a range of views on greenhouse policy. This submission accords with the views of AIGN members in general, though it may differ in particulars from the positions of some individual member associations and companies. Some have prepared submissions of their own, and this AIGN submission should be read in conjunction with those submissions.

AIGN notes that the stakes for our members on climate change are very high and it is critical for us to be engaged in this work. The impact of policy measures on export and domestic industry competitiveness, including the impacts on electricity generation, is particularly sensitive and, given the 'engine room' status of these industries, the implications are critical also for the national economy.

This sensitivity is particularly pronounced given the uncertainty of the global economy and the uncertainty associated with the development of a robust global agreement to cut greenhouse gas emissions. Developing environmentally effective and economically efficient strategies to manage greenhouse gas emissions in a way that accounts for these uncertainties is a key challenge that policymakers have so far failed to address in the design of the CEF.

This submission has two parts — the first is AIGN's assessment of the policy design; the second recommends specific amendments to the CE Bill to avoid unintended consequences. AIGN notes that the full implications of the Bills remains unknown until all the Regulations are made available for scrutiny.

2 POLICY FAILURE IN THE BILLS

AIGN urges the Government to reconsider a number of the policy positions that have been adopted so that the Government's own objective of economic reform at least-cost is made possible.

2.1 Economic reform at least-cost

Two of the fundamentals underpinning the Government's rationale for introducing an emissions trading scheme from 1 July 2012 are that:

1. The reform would be least-cost; and
2. The reform would mitigate the investment uncertainty that has been created by the policy process over the last few years.

2.1.1 Least-cost

The CE Bills fail the least-cost objective on at least five key fronts:

- At $23/t the CEF imposes on Australians a price that is at least 50% higher than the price being paid by Europeans
- The emissions trading scheme can make few claims to being economically efficient with no more than 65%[1] of emissions and sectors covered by the scheme
- While the caps for the scheme are yet to be set, the default caps burden the scheme with meeting almost 100% of Australia's international pledge to 2020 whilst covering about 65% of emissions. This can only result in low cost emission abatement being missed and replaced with either higher cost abatement in covered sectors or in the purchase of international units. This increase in costs is supported by Treasury's modelling which shows a higher marginal cost of abatement in the CEF scheme compared with the CPRS scheme, which covered around 75% of emissions
- The potential restriction on the eligibility of international units will force higher cost domestic abatement and distort international markets

[1] AIGN understands this is DCCEE's estimate taking account of the fuel excise rebate clawback.

- Nothing in the Bills deals with the already 237 measures identified by the Productivity Commission as imposing costs higher than an emission trading scheme, or the proliferation of more overlapping and costly policies at Federal and State level.

Overall, the Bills do not meet the least-cost economic reform objective set by the Government. Further, it departs from the policy setting of the White Paper which was to avoid being a mechanism for wealth transfer — AIGN estimates that the CEF could effect a wealth transfer of over $25 billion in the next ten years from manufacturing, mining and energy transformation industries to households, renewables and agriculture.

2.1.2 Investment uncertainty is hightened

A driving force behind the CEF has been the Government's claim that it would restore investment confidence.

For trade-exposed industry, the Jobs and Competitiveness Program (JCP) introduces a range of new uncertainties that may restrict investment in abatement and new production:

- The prospect of an equivalent emissions cost being placed on the majority of Australia's import and export trade competitors remains remote
- It is proposed that the Productivity Commission will review the JCP three times in five years between 2014 and 2018. The PC has the scope to recommend a complete recasting of the JCP scheme and radical changes to the treatment of individual activities, the prospect of which is likely to undermine the business case for any investment in emission reduction in JCP industries in the next five years.

The design of the JCP, and in particular the establishment of activity average baselines, is an important driver of efficient investment in emission reductions in the eligible industries so that they meet the Government's goal of encouraging a transition to lower emission intensity in every activity whilst remaining competitive. By introducing uncertainty around that design, including that the baselines may be altered after investments dependent on them have been made, will stifle those investment opportunities.

For investment in electricity generation, and particularly baseload capacity, the investment dilemma created by policy uncertainty that existed before the CEF Plan not only remains, but is multiplied:

- The potential buyout and closure of a large brown coal-fired generator, and the conditions attached, are unknown. No new investment in either gas-fired or CCS ready coal-fired baseload will progress until this policy is resolved
- The fact remains, and is once again confirmed by Treasury modelling, that the RET is crowding out, for perhaps the next 10 to 15 years, a more cost-effective emission reduction investment in gas-fired generation capacity
- The intrusion of the Clean Energy Finance Corporation into the electricity market supporting a restricted range of generation capacity has the potential to be an ongoing source of uncertainty for investors
- In addition to the impact on brown coal plant, the Plan strips over $5 billion in asset value out of coal-fired generation in NSW, Queensland and WA, with implications in the first two States for government revenues and, hence, potential tax increases in those States.

This escalation of uncertainty has implications for the international competitiveness of Australian industry.

2.2 Industry support

The CE Bills propose a program of unit allocations to emission intensive trade-exposed industry, selected coal-fired electricity generators and grants for some other industry.

2.2.1 Trade-exposed industry

It is important that the rationale for transitional allocation of emission units to trade-exposed industry be re-stated. The rationale is created by two circumstances:

- The decision to place a price on Australian emissions from 1 July 2012 and hence to impose a competitive cost disadvantage on Australian industry; and

- The uncertainty about when, and the extent to which, international competitors of each of Australia's trade-exposed industries will impose similar costs.

The proposed JCP program does not apply to all trade-exposed industries and does not fully offset the competitive disadvantage of those import and export competing businesses that do qualify. The outcome will be a loss of jobs and investment, in return for an uncertain environmental gain.

Within the coverage of the proposed emissions trading scheme, trade-exposed businesses in manufacturing and mining account for around 200 million tonnes of CO_2-e. However, the budget accompanying the CEF Plan asserts that the allocation of just 124 million units will be sufficient to ensure no loss of competitiveness, investment and jobs from these businesses.

A key mischief promoted in this debate is that emissions unit allocation to trade-exposed businesses is a gift of taxpayers' money to 'rent seekers'. Assuming the price trajectory implied by the Government's documents, the emission units in the trading scheme and the fuel excise rebate clawback will be valued at over $120 billion in the first 10 years of the scheme. This $120 billion is not a magic pudding of taxpayers' money created from nothing. Rather it derives from the increased costs of living for households and the lost competitiveness of over 100,000 mining and manufacturing businesses.

AIGN estimates that the result of the CE Bills is that the Government may impose about $75 billion in costs on trade-exposed businesses, but is proposing to provide about $50 billion in relief — the JCP scheme, as expected in the Regulations yet to be released, will erode the trade competitiveness of import and export competing businesses in Australia by an estimated $25 billion over the next 10 years.

2.2.2 Electricity generators

The CE Bills propose to allocate cash and emissions units to a few coal-fired electricity generators that will suffer considerable asset value loss under the emissions trading scheme. The level of compensation offered is about $5.5 billion.

However, not all electricity generators that bear a significant asset value loss are eligible for the scheme. It is estimated from Treasury modelling that NSW and Queensland coal-fired generators that will not receive any compensation could suffer a combined loss of $5-6 billion in asset value.

This is not simply an inequitable outcome, it may also have important implications for investment in generation capacity in those States and, ultimately, unnecessary and economically inefficient increases in electricity prices.

2.2.3 Shifting the burden

Some commentators assert that emission unit allocation to trade exposed industry increases the economic cost of the CEF and shifts the burden of emission reduction costs to households and other sectors of the economy.

The Treasury modelling debunks two claims associated with these assertions:

- Unit allocation to industry does not increase the economic burden of the rest of the economy because, contrary to the claims, it does not induce an increase in emission unit prices. Where unit prices in Australia are either controlled by international prices or by a sensible 'safety valve' price, the allocation of units within Australia does not change the unit price in Australia
- Unit allocation to industry should not, as claimed, reduce the incentive for these industries to invest in emission reduction opportunities. The proposed unit allocation design, based as it is on benchmark emission intensities, preserves the power of unit prices to induce efficient investment in emission reductions. However, as outlined above, the reviews proposed for the JCP in the CE Bills have cast doubt over the future of this important design feature.

Export and import competing industry has, by definition, limited ability to pass-through increased costs associated with an emissions price, because the prices of their products are determined in international markets. This means that households do not pay increased prices for those products, and have no claim on the emission units, or revenue from sale of those units, associated with those products.

Rightfully allocating units to trade exposed businesses does not shift the burden to the rest of the community. On the contrary, arbitrarily restricting allocation shifts the burden to trade exposed businesses, and subsidises households. The Government has already conceded that it is over-compensation households by at least 20%, and that compensation money is being taken out of trade-exposed businesses and electricity generators.

In fact, the Government has deliberately designed the CEF to shift the burden of Australia's international commitments to reduce emissions onto those sectors covered by the CE Bills. The default caps proposed for the scheme mean that almost 100% of Australia's commitment will be carried by just 65% of Australia's emitting activities.

2.3 Other concerns

AIGN is concerned that the economic implications of the CE Bills cannot be fully assessed at this time for two key reasons.

First, many of the key elements that will determine the economic impacts are not evident in the draft Bills including:

- The economic implications for Australia are closely tied to the economy-wide emission commitments Australia adopts relative to the commitments adopted by other countries. At this time, only a handful of advanced countries, where 'advanced' is defined as all countries with GDP per head at least as high as the Ukraine in line with Australia's submissions to the UNFCCC, have committed to their Cancun pledges in national laws or plans. Most advanced countries are unlikely to commit to their pledges much before 2015.
- A significant determinant of the level of impact on the economy will be the elements of the CE Bill designed to offset the loss of trade competitiveness of export and import competing industry during a period of transition to a coordinated and comprehensive global commitment to reduce emissions. The draft Bills devote just a few pages to this vital element of design and provides no detail of substance. AIGN understands that all of the details that will determine the impacts on trade-exposed industry will be contained in regulations and the final set of these regulations may not be brought before Parliament until the first quarter of 2012, just a few months before the scheme is scheduled to commence. AIGN notes that draft regulations for the JCP were released on 22 September, the day before this submission was due to the Select Committee.
- Although the elements of the CEF impacting on the electricity generation sector are more detailed in the draft Bills, because important elements will be set in regulations and perhaps the most significant, the closure of an existing brown coal-fired generator, is to be pursued outside the legislation, the full impacts will also not be known for some time. AIGN notes that draft regulations for the generators were released on 22 September, the day before this submission was due to the Select Committee.
- The CE Bills will be just one element of a balanced response to reduce emissions. In particular, to reap the economic efficiency rewards of an emissions trading scheme a strong commitment is needed to expanding the emissions coverage of the Bills and, importantly, the plethora of Commonwealth and State schemes that impose additional costs on industry need to be removed. There is nothing in these draft Bills that address these issues.
- AIGN notes that the modelling so far released by the Treasury provides very little insight into the likely economic impacts on Australia. None of the scenarios modelled by Treasury address one of the most likely international outcomes — that being the Government's commitment to a -5% below 2000 emission unit budget by 2020 within a fragmented international agreement. The short to medium term economic costs are not measured by Treasury modelling and the environmental benefits remain very uncertain in the absence of a robust international agreement. To enable a transparent investigation of Treasury's modelling, the models and data actually used by Treasury need to be able to be accessed and peer reviewed.

Second, the scope and longevity of deteriorating global economic conditions raises considerable uncertainty about the capability of industry and households to fund emission saving investments to respond to the price signal being created by the CE Bills. For as long as these circumstances continue to prevail, industry and households will in effect be confronted with a tax that they cannot avoid, thereby limiting the domestic emission reductions that can be effected. The only alternative is the purchase of international units that, while it is necessary to achieve least-cost, nevertheless results in more than $3 billion per annum of wealth being transferred out of Australia to other countries by 2020.

2.4 AIGN recommendations

In AIGN's view, if flaws in the CEF are to be avoided, and the Government's policy intent fully given effect, then the legislation will need to:

- Adopt a national unit budget to 2020 based on Australia's -5% commitment that is fair compared to the obligations of other countries. This may require acceptance of an increase in annual emissions budgets before a trajectory is set to meet -5% in 2020.
- Cover substantially more than 65% of emissions from the beginning so that an arbitrary and inefficient allocation of the national budget between the sectors covered by the CE Bills and the rest of the economy can be avoided.
- If the fixed price period is retained, set prices that reflect international prices. The forward December 2012 price for CDM units is currently less than $15/t, making Australia's starting price of $23/t punitive.
- Given the uncertain circumstances around establishing a comprehensive global market, set a sensible 'safety valve' price trajectory to 2020 that caps the economic impact that the community is prepared to accept. This price trajectory could be abolished when the community had confidence in the maturity and stability of the domestic and international emissions markets. The current proposition that the ceiling price should start at $20/t above international prices and should grow at 7.6% per annum is unrealistic and, if it came into effect, would signal a dysfunctional international price.
- Fully offset the loss of trade competitiveness of industry. AIGN estimates that import and export competitive manufacturing and mining industry accounts for up to 200 million tonnes of emissions, whereas the Government estimates an initial allocation for 2012-13 of just 124 million units. Amendments to the trade exposed industry program in the CEF would include
  - determine all exports to be trade exposed
  - determine import competing products whose prices move in tandem with import parity as trade exposed, and the trade exposure of other import competing products to be assessed by the Productivity Commission
  - remove the zero, 66% and 94.5% assistance rates – to be fully effective, all trade exposed operations should receive up to 100% of scope 1 units and up to 100% of units needed to fully offset costs passed-through by non-trade exposed industry (typically in electricity prices, gas prices and feedstock prices)
  - remove the carbon productivity tax of 1.3% per annum
  - remove the artificial definitions of 'activity' that currently mean that all trade exposed facilities will receive effective rates of allocation below 94.5% and 66%
  - removal of unit allocation to be determined by the Minister within the legislation on a product-by-product basis reflective of the effective emission costs imposed in the relevant product competitor countries. The Minister's decisions should be reviewable by the Administrative Appeals Tribunal.
- Provide $10 to $12 billion of assistance to the electricity generators suffering asset value loss in the form of emissions units over 15 years.
- Provide for the abolition or phasing out of the majority of the 237 existing schemes identified by the Productive Commission as higher cost that an emissions trading scheme, including the RET scheme, and provide a means to prevent the adoption of new schemes that impose additional costs on industry
- Establish all publicly funded programs for RD&D into frontier emission reduction technologies, including the Clean Energy Finance Corporation, so that their aims and objectives are technology neutral.

3 SPECIFIC AMENDMENTS TO THE CLEAN ENERGY BILLS

In the limited time available since the release of the CE Bills, AIGN has identified a number of amendments that need to be made to the CE Bill to avoid unintended consequences.

1. Clause 14(2): insert a new paragraph "must have regard to the proportionate distribution of Australia's international obligations between the emissions covered by this Act and the emissions outside this

Act." AIGN's argument is that this amendment is necessary in order to meet the object in clause 3(c)(ii) related to cost-effectiveness. It is important that the Minister and the Climate Change Authority are guided by the objects of the Act in the important decisions and assessments that they must make. Without this amendment, both the Minister and the Authority may misinterpret the Act to require the whole of Australia's international commitments to be met by the Act.

2. Following on from 1 above, amend clause 17(2) by replacing 38,000,000 with 21,000,000 and in clause 18(2) replace 12,000,000 with 7,000,000. A new section should be added to limit clause 18(2) to the year starting 1 July 2019. This would ensure that the default budget to 2019-20 is about 60% of Australia's -5% pledge under the Cancun agreement.
3. Delete clauses 72(4) and (5). There is no case for penalising the operator of a UJV because a participant of the UJV fails to meet its compliance obligations. The commercial nature of a UJV is several, meaning that each participant carries on business in its own right. The current provisions would require the operator to take on a risk that is disproportionate with its receipt of revenues from the UJV. Where liability is transferred to each JV participant, that liability is binding, as it is in relevant tax legislation.
4. Include provision for reverse auctions and deferred payment arrangements in clause 113(2). This will add flexibility to auction design.
5. Amend clause 116(2)(a) to read 1 July. Buy-back should be made available as early as possible given that electricity and gas prices will have already risen. AIGN appreciates the practicalities involved, however, setting the date at 1 September precludes improvements in efficient regulation.
6. Amend clause 116 to remove the discount that is applied to the buyback by the Regulator. Most fixed price units that will be sold to the Regulator will be sold to offset the liability associated with indirect emissions (increased electricity and gas prices). These costs will not be discounted by the suppliers of such products and services, and are likely to be charged on an accruals basis at the full unit price. As such, in order to ensure that companies with significant indirect liability are not penalised, the price for the sale of such units should not be discounted.
7. Clause 123 raises the prospect that an investment may be made in a CDM project (with CERs distributed over say 15 years of the project) and that subsequently some of the CERs become ineligible. This creates significant uncertainty for Australian investment in abatement in developing countries. The clause should be amended to protect against retrospectivity.
8. Clause 124 establishes for the first three flexible charge years that there could be a charge imposed on the surrender of eligible international units. This charge will be imposed by the *Clean Energy (International Unit Surrender Charge) Act 2011*. AIGN understands that it is proposed that a Regulation be made that allows for the annual calculation of the charge to apply to all purchases of international units for that year. This is very likely to result in the imposition of an incorrect charge for the most purchases since the regulated charge is likely to be an average of posted world prices. To avoid this outcome, purchasers of international units should be allowed to disclose the purchase price so that the charge is based on that price, not the regulated price. Disclosure of the purchase price will in any case be necessary in the claiming of the costs of international units for company tax purposes.
9. Clause 143(2)(f) should be deleted as this test is inconsistent with the policy intent of the JCP as set out in clause 156(3)(a). The test imposed by clause 143(2)(f) is a macro-test related to actions taken on a country-wide basis by major emitting countries – it is a test that is nowhere referenced in the Government's policy document "Securing a clean energy future" nor in any other parts of the legislation — it would appear to be an unintended carryover from the CPRS Bills. Clause 156(3)(a) however is the policy set out by the Government and is an activity-by-activity test to be undertaken by the Productivity Commission. The two are incompatible.
10. Clause 155(1) provides for 3 reviews in the first 5 years of the JCP. This creates uncertainty that will undoubtedly frustrate the objectives of the Act and

Part 7 to encourage investment in abatement in these industries. The first review should be in 2015-16 thereby allowing 3 years of operation of the scheme and ensuring investment undertaken is underpinned by the existing rules until 2020-21.

11. Consistent with clause 143(2)(e) and 156(2)(d), clause 155(2)(b) should make reference to the impact of Australian emission reduction measures as well as this Act.

12. It is difficult for industry and the Productivity Commission to understand the intent of many of the elements of clause 156(2) and there is no guidance in the Explanatory Memorandum. This is concerning as the Productivity Commission 'must' have regard to all these matters and many of them would seem to have no relevance to the objects of Part 7. Taking just one example, clause 156(2)(b) makes reference to progress in achieving best practice. How should this be interpreted — that a great deal of progress has been made and the assistance should therefore be reduced, even though the progress is based on investment underpinned by the scheme? or that little progress has been made and assistance should be reduced even though the reason was because the activity is struggling to remain competitive under the Act? AIGN recommends that clause 156(2) be deleted and that the work of the Commission be guided by the aim and objects of Part 7. If the legislation is to give no guidance to the Commission and the provisions are to remain, then at least clause 156(2) should be amended to replace 'must' with 'may'.

13. The reference to 'foreign countries' in clause 156(2)(d) should be changed to 'foreign competitors'.

14. The relationship between clause 156(5)(b) and 156(2)(f) is unclear and could have the unintended consequence of aligning reduction in emissions with windfall gains. Some redrafting to reflect the real intent of this clause is needed.

15. The policy intent of the JCP in this legislation is to limit the cost impact of Australian emission reduction measures on each emissions intensive trade-exposed activity until similar costs are imposed by foreign competitor countries on their activities, and to promote investment in emission reduction. It is also the policy intent that the assistance rates have a floor of 90% and 60% (clause 156(5)(b)) in the circumstances where less than 70% of an activity's competitors have yet to impose similar costs. As currently drafted, the legislation provides a default 1.3% carbon productivity tax on assistance rates creating two concerns that will undermine the policy intent. First, AIGN understands that there may be over 50 activities that qualify for the JCP and is concerned that the Productivity Commission will not be in a position to fully assess all activities in all relevant countries before the assistance rates fall below the floor levels as a result of the carbon productivity tax of 1.3% per annum set out in the draft regulations (clause 907 of the draft regulations). Second, the default tax reduces the business case for investment in emission reduction by eroding the number of units freed for sale to support the return on investment. AIGN recommends that it would be prudent, in order to avoid these unintended outcomes, that the floor rates of 90% and 60% to be legislated and that clause 907 in the draft regulations be amended to ensure that the 1.3% productivity rate may only apply below 90% or 60% for an activity where the Minister, having regard to a Productivity Commission report, makes a regulation.

16. Clause 288(6) should be strengthened to ensure that the Climate Change Authority undertakes public consultation in a manner similar to that of the Productivity Commission with a transparent process involving holding hearings, discussion papers, draft reports and final reports all for public comment (see for example Part 3 of the Productivity Commission Act 1998)

Attachment A: AIGN Membership

Industry Association Members

Australian Aluminium Council

Australian Coal Association

Australian Food and Grocery Council

Australian Forest Products Association

Australian Industry Group

Australian Institute of Petroleum

Australian Petroleum Production and Exploration Association

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 Ltd

BlueScope Steel Ltd

BP Australia Limited

Caltex Australia

Cement Australia Pty Ltd

Chevron Australia Pty Ltd

ConocoPhillips Australia

CSR Limited

ExxonMobil Australia Limited

Hydro Aluminium Kurri Kurri Pty Ltd

Incitec Pivot Ltd

Inpex Browse Ltd

International Power GDF-Suez Australia

Leightons Holdings Ltd

Origin Energy Limited

Qenos Pty Ltd

Rio Tinto Australia Limited

Santos Limited

Shell Australia Limited

Stanwell Corporation Limited

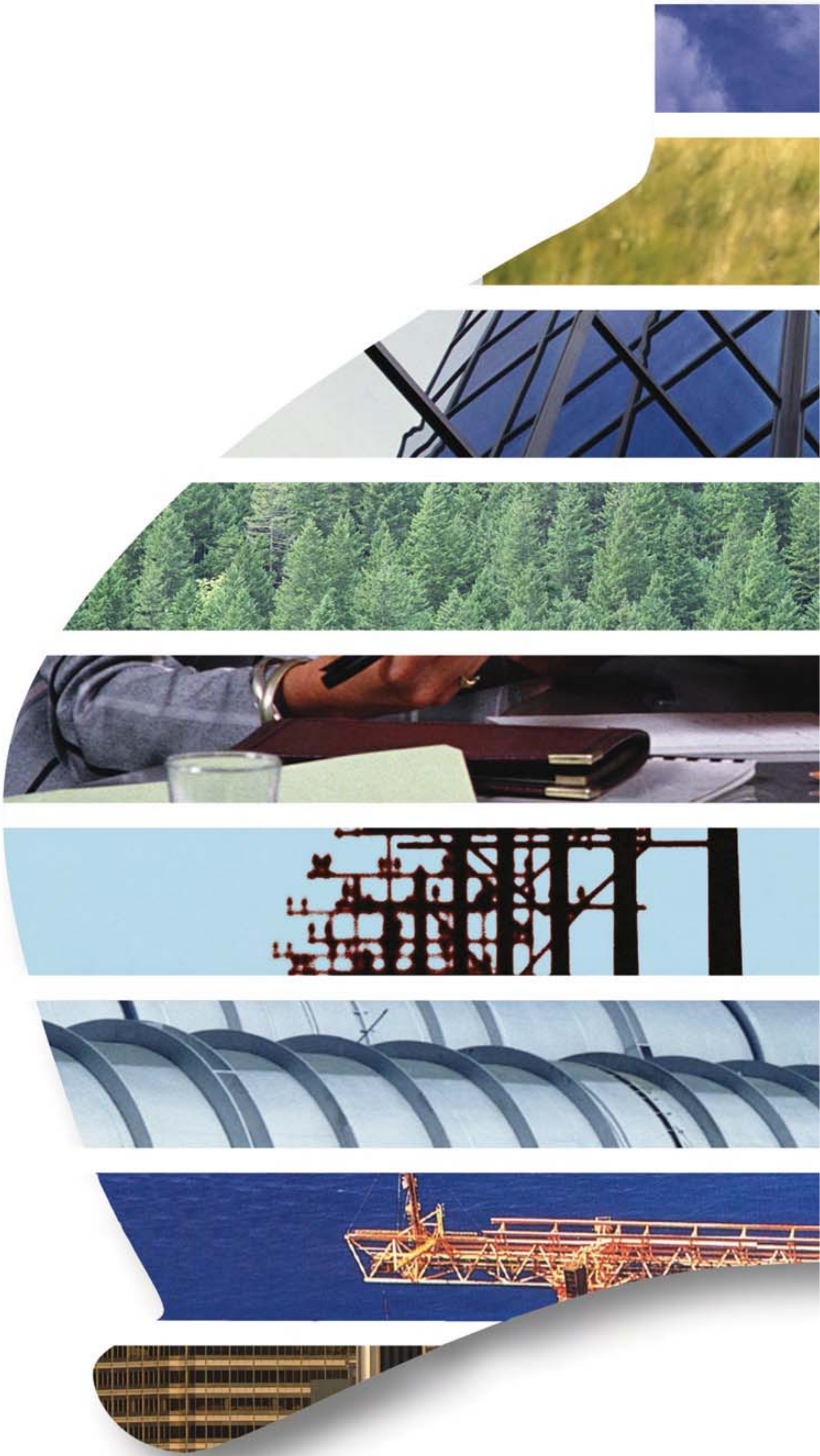
Tomago Aluminium Company Pty Ltd

Thiess Pty Ltd

Wesfarmers Limited

Woodside Petroleum Limited

Xstrata Coal Australia Pty Ltd



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