22nd September 2011

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Australian Aluminium Council submission to the Joint Select Committee on the Clean Energy Future (CEF) legislation

The Australian Aluminium Council (AAC) welcomes the opportunity to make this submission to the Joint Select Committee on the Clean Energy Future (CEF) legislation.

The submission is specific to the current stage of the policy development process. There are a number of significant elements of the policy to which we object and have been consistently seeking changes. For consistency, we have covered these aspects in the attachment.

We do, however, draw your attention to a single request for a change in the legislation that we believe is consistent with the announced policy. In fact, the change we are seeking will provide greater certainty that the announced policy will be implemented.

Clause 156(3), along with the previous policy document and public statements, makes it clear that to underpin investment from industry the Government is proposing that the decay in permit allocation to industry should pause at 90% for highly emissions-intensive activities if less than 70% of relevant competitors face a comparable carbon cost.

There are, we believe, two primary aims for this policy element:

1. To ensure that an investment in emissions reduction (such as a co-generation project) that is brought on by a carbon price is not then left stranded by reduced competitiveness of that facility.
2. To provide (some) assurance to emissions-intensive trade-exposed industry that Australia's carbon cost will not increase significantly out of alignment with our competitors.

In developing policy to meet these aims, the Government is imposing two caveats:

A. That future Governments should make this decision based on the circumstances prevailing at the time.
B. That the assessment of those circumstances should be based on rigorous independent analysis by the Productivity Commission.

Our concern is that the manner in which the caveats are being implemented, particularly the freedom for future Governments, significantly undermines the aims. By telegraphing and over-emphasising the freedom for future Governments to make a decision based on the circumstances at the time, the policy element provides virtually no assurance to industry about carbon costs relative to our competitors and is in a form that could not be incorporated into cash flow projections of a potential investment – thereby undermining the prospects of such an investment.

We believe that the two aims for the policy element described above can be more effectively achieved, while still imposing the two caveats, if the 90% pause in permit allocation in decay was the default position, subject to a review and recommendation from the Productivity Commission leading to a decision by the Minister of the day. The decision would still be based on rigorous and independent analysis by the Productivity Commission; the Government of the day would still make the decision based on the prevailing circumstances; but, importantly, the policy element would actually deliver assurance to industry about relative carbon costs and, most crucially, would provide sufficient assurance for potential investments to be costed and assessed based on the floor in permit allocation.

There are many steps in the process outlined in Clauses 155 and 156 where the intention of the Jobs and Competitiveness Program may fail to be delivered including, amongst many: delays in the inquiries; inconclusive findings; opaque policies in competing countries; and the inability of parliament to successfully make supporting regulations.

Leaving clause 156(3) as currently drafted dilutes what has been communicated as a certain part of the policy, to something that is simply a possibility. This forces the emissions-intensive trade-exposed sector to carry all the risk; including for Government delays, difficulties in assessing other countries' policies and changes in interpretation. This is not reasonable, particularly given that all those factors are outside the control of the emissions-intensive trade-exposed sector.

It should be noted that this is more than a simple hypothetical scenario. Given the current state of international progress in implementing carbon costs, it is highly likely that in 2015 many industries will be facing the situation that less than 70% of their competitors are paying a comparable carbon cost.

Clause 156(3) should be redrafted, and the regulations written, to implement the 90% floor in permit allocation for highly emissions-intensive industries as the default position until it has been demonstrated (by the Productivity Commission) that more than 70% of competitors face a comparable carbon cost.

Thank you for the opportunity to provide comments to the Joint Select Committee on the Clean Energy Future (CEF) legislation. We would welcome the opportunity to provide further information if required. Please contact me if you have any questions.
Yours sincerely

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Attachment – Comments on the Clean Energy Future Policy

This attachment is divided into two parts: the first part deals with specific sections in the legislation relating to the Jobs and Competitiveness Program (JCP); and the second part covers a range of issues not covered in the legislation.

Jobs and Competitiveness Program

We note the aim and objects of the Jobs and Competitiveness Program (JCP) in relation to emissions-intensive trade-exposed activities (EITEs) include "to reduce the incentives for such an activity to be located in, or relocated to, foreign countries as a result of different climate change polices". In the face of uncertainty over the pace and co-ordination of global action, a key interest for domestic industry is the extent that Australian industry will be exposed to increases in carbon costs compared to the costs being imposed in competing countries.

Predictability and caution in this area may mitigate the otherwise escalating risk of operating in Australia and may provide the conditions for ongoing investment in EITE facilities including sustaining capital and emissions reduction measures. However, these risks will only be reduced if a potential investor has confidence that the announced policy measures will be implemented. The Australian aluminium and alumina industries invest on a long term (>30 year) horizon and in making investment decisions will only be able to rely on detail which is in legislation (or at least regulations). Policy which is not implemented in full or where the default position is in the negative, will result in decreased investment, including in abatement, for Australia's value adding industries.

The current legislation has too many steps where the bureaucratic and political process may fail to deliver, or delay, the intended outcome.

Link between 70% test and permit allocation

Part 7 (Jobs and Competitiveness Program) Division 5 (Productivity Commission inquiries) Section 156 (3) of the legislation requires the Productivity Commission to consider:
"(a) whether less than 70% of the relevant competitors… are located in countries… where the impact… of emissions reductions measures… is comparable to the impact on the industry of Australian… measures…
(b) whether, having regard to the matter in paragraph (a), the… rate of assistance… should pause when assistance rates reach (i) 90% for highly emissions-intensive industries; and (ii) 60% for moderately emissions-intensive industries."

As currently drafted this clause provides little predictability regarding future permit allocation and falls well short of the stability needed to attract investment, including in emissions reductions. It merely outlines some matters that will be considered in the review. There is only a soft link in the legislation between the test in the first part (70% of competitors) and the implied resultant outcome in the second part (permit allocation pausing at 90%).

Furthermore, the 70% test and the floor to permit allocation are only matters that the Productivity Commission may consider in its recommendations. The draft legislation does little to guide or constrain the Minister's response to the Productivity Commission recommendations with respect to the 90% floor to permit allocation.

Even an informed participant in the industry who may feel confident about the answer to the test would not be able to predict the outcome and would therefore be unable to make informed investment decisions. More importantly there is significant potential that the circumstances that justify the JCP measures – competitors who do not face a comparable carbon cost – will exist; but the expected remedy – permit allocation at 90% for highly emissions-intensive activities – will not be provided by the Government.

Given the extent that the legislation provides predictability and certainty for other elements of the package, it is unreasonable to leave emissions-intensive industries exposed to such an extent.

Clause 156(3) should be redrafted, and the regulations written, to implement the 90% floor in permit allocation for highly emissions-intensive industries as the default position until it has been demonstrated (by the Productivity Commission) that more than 70% of competitors face a comparable carbon cost.

Impact of emissions reduction measures in competing countries

Clauses 143(2)(e) and (f), along with clause 156(2)(d) provide the global "grounding" for the JCP and the inquiries by the Productivity Commission. However in each instance it currently refers to whether countries have introduced measures that have an impact that is comparable to measures in Australia. In contrast, Clause 156(3)(a) refers correctly to the "impact *on those competitors* of emissions reduction measures". The distinction between the impact of measures to reduce emissions in a national economy, and the impact of those measures *on competing facilities* at the costs of production level, is critical to one of the objects of the JCP "to reduce the incentives for such an activity to be located in, or relocated to, foreign countries as a result of different climate change policies".

Clearly incentives for location, or relocation, are created, not simply by the existence of measures to reduce emissions, but by the impact of those measures *on competing facilities*. A failure to amend clauses 143(2)(e) and (f) and clause 156(2)(d) creates the risk that the remedy provided by the JCP will not be available at some point in the future to Australian EITEs even though the distortion that it supposedly addresses persists.

Clauses 143(2)(e) and (f) and clause 156(2)(d) should be amended to specifically refer to the impact *on competitors* of emissions reduction measures (including the impact of associated assistance) when justifying or assessing the continuance and levels of the JCP.

Clarity around Productivity Commission inquiries

The current drafting of the Bill does not provide sufficient detail to affected parties of what the Productivity Commission will be asked to examine about the policies of other countries and, most importantly, what to do if the policy or the impact is unclear.

Of particular concern are instances in competing countries where: the nominal national policy is modified by policies in place at provincial or regional level; is not enforced for large, government-owned or strategic facilities; or is simply not implemented or enforced.

The objective of assessing whether comparable carbon costs are being imposed on competitors can only be achieved if the Productivity Commission has the time, resources and authority to collect the necessary information and to determine these matters. It is highly questionable if it is possible for an official Australian body to be able to gather the necessary information in some competing countries or make the public judgement to fairly assess the outcome.

In turn, that triggers the question of what should happen if the inquiry is unable to reach a definitive conclusion, or is of the view that the nominal national policy is not a reflection of the carbon costs in reality. The objective of the policy suggests that in these circumstances, the permit allocation to Australian EITEs should pause. The current proposal does not do this. However, redrafting the Bill to default to the 90% floor for highly emissions-intensive industries until it has been demonstrated that more than 70% of competitors face a comparable carbon cost, would achieve the claimed outcome.

It should also be noted that the Productivity Commission is being asked to undertake an enormous body of work with significant implications for Australia's manufacturing industry. There are approximately 40 emissions-intensive, trade-exposed activities already identified. The major international competitors will be different for each of these activities and within each competing country the treatment of those activities will vary. The number of activity-country combinations (e.g., aluminium smelting in China) that will need to be closely studied to complete the task will be in the hundreds. Yet under the draft legislation, all the risk if that work cannot be completed in time, or is inconclusive due to the magnitude of the task, is borne by industry.

No decay in permit allocation until matched by other countries

The *possible* floor in permit allocation that *may* be implemented following the Productivity Commission inquiry is set at the level of 90% for highly emissions-intensive industries. This suggests that Australian EITEs will see a significant rise in carbon costs – from an exposure of 5.5% at $23 per tonne, to an exposure of 10% at a market set price - before there is any consideration of the carbon cost being imposed on competitors. Yet the recent Productivity Commission review concluded that even prior to the imposition of the Clean Energy Bills the Australian carbon cost is already comparable to our major competitors. Australian EITEs will bear a higher carbon cost than our competitors at the start of the carbon pricing regime and this will rise further before there is any consideration of competitiveness impacts.

This proposed approach fails to meet the objects of the JCP and does not follow the logic of the program. It will see Australian aluminium facilities face a carbon cost of over $100 per tonne of aluminium before competing facilities in China are likely to pay any more than $13 per tonne of aluminium as shown in a recent study for the Council by Clark & Marron. Such discrepancies are material to the operation of facilities and investment decisions – increasing "incentives for such an activity to be located in, or relocated to, foreign countries" that the JCP is supposed to reduce.

This threat to the competitiveness of Australian facilities can be addressed by not implementing any decay in permit allocation under the JCP until it has been demonstrated that more than 70% of competitors face a comparable carbon cost; that is, creating a floor to permit allocation of 94.5% for highly emissions-intensive industries.

All of the remedies proposed above for the current wording around the 90% floor, could be applied to the 94.5% allocation with no decay, as proposed here.

Longevity of the Jobs and Competitiveness Program

Clause 143(2) proposes that the JCP will be in place "until such assistance is no longer warranted, having regard to:… whether foreign countries that are responsible for the substantial majority of the world's emissions of carbon dioxide and other greenhouse gases have implemented measures to reduce those emissions that have an impact that is comparable to the impact of Australian emissions reduction measures (including the impact of associated assistance)".

The general nature of these words; the ambiguity around terms such as "majority of the world's emissions", "measures… that have an impact that is comparable"; and the difference between the majority of the world and the competitors in a specific activity, are major sources of risk for companies undertaking EITE activities and significantly undermine the confidence and investment that the JCP is meant to induce.

The clause creates the threat that the JCP could be ended by a subjective qualitative judgement on global action without reference to specific activities, and actual costs in Australia and overseas.

This clause should be deleted, so that the JCP does not have a closure clause hanging over it. Then a participant in an EITE activity can be confident that the JCP, and the permit allocation it provides, will remain in place unless the conditions outlined in clause 156(3)(a) have been demonstrated – i.e., that 70% of relevant competitors face a comparable carbon cost.

Aim and Objects of the Jobs and Competitiveness Program

As outlined above, there is considerable risk built into the current drafting of the Jobs and Competitiveness Program including the lack of specific direction to the Productivity Commission for the reviews, and to the Minister in responding to the PC reviews.

A potential steadying factor is the aim and objects for the Jobs and Competitiveness Program (Section 143) and for the Act itself (Section 3). Any review will be guided by these sections as they define what the Act and Program are trying to achieve and they (loosely) constrain future Governments in that any changes to the regulations and programs would have to still meet the objects.

For these reasons they are important clauses and should be the subject of greater explanation and negotiation to ensure they correctly capture the objects. The Council believes that the current wording fails to capture the publicly stated justification of the JCP particularly and also includes phrases that are sufficiently vague to allow almost any changes by future Governments, even outside the spirit of the Act and the Program.

ISSUES NOT INCLUDED IN THE LEGISLATION

The following issues are not direct comments on the legislation but relate to the policy in general.

Classification of highly emissions-intensive activities

The Council acknowledges that the recent policy announcement and the legislation retain the approach that sees alumina refining and aluminium smelting treated as "highly emissions-intensive" activities and is likely to see aluminium rolling also treated as "highly emissions-intensive".

Measures to address the cost of higher-emission electricity

Electricity supply is one of the few sectors of the Australian economy that is not trade exposed and hence is able to pass through a carbon cost. It is the users of electricity that will pay the carbon cost on electricity supply.

Given the variability of carbon intensity amongst electricity generators and the complexity of the National Electricity Market it is not a simple matter to estimate the level of cost uplift to consumers. The Government commissioned modelling during the development of the CPRS that led to the selection of an Electricity Allocation Factor (EAF) of 1.0 t CO_2e /MWh – that is, a rise in the price of electricity, of the value of 1.0 tonne of CO_2e, per MWh of electricity. This is applicable in most situations.

However where electricity is purchased through direct contracts between the supplier and electricity user, there is potential for a carbon cost significantly greater than 1.0 t CO_2e/MWh. In these limited instances the EITE permit allocations must include measures to address the cost of higher emissions electricity.

Permit allocation for domestic gas use

EITE industries that use gas will be exposed to significant increases in costs from at least three sources: the carbon cost of direct emissions from burning gas; the carbon cost of emissions associated with extraction and transmission of gas; and an increase in gas prices relative to higher emissions fuel sources. The first of these cost increases – the carbon cost of combustion – is part of the permit allocation to EITEs under the JCP. The last of the cost increases – increased gas costs – is a market exposure similar to many factors of production including other fuel sources.

However, the second of the cost increases – the carbon cost of emissions from extraction and distribution – is not part of permit allocation to EITEs, even though the analogous situation for electricity supply is covered. This different treatment is arbitrary and counter to the objectives of carbon pricing given the low emissions nature of gas as a fuel source. Given that LNG export also attracts EITE assistance, the policy discourages the use of gas in domestic value adding industries. The JCP should include permit allocation to gas users for the (Scope 3) emissions associated with extraction and transmission of gas.

Removal of 100% cap on permit allocation

The Council acknowledges the removal from the policy of the 100% cap on permit allocation to EITE activities.

The previous proposal stifled the incentives to abate in some operations, as well as failing to acknowledge the benefits of early action. Its removal was warranted.