# Chapter 4

## The effectiveness of the CPRS as an emissions trading scheme

4.1 This chapter sets out the findings of the Select Committee in relation to the choice of the Government's emissions trading scheme as the central policy to reduce Australia's carbon pollution taking into account the need to:

(a) reduce carbon pollution at the lowest economic cost,

(b) put in place long-term incentives for investment in clean energy and low-emission technology, and

(c) contribute to a global solution to climate change

### Coverage of the scheme

4.2 The CPRS will cover a range of greenhouse gas emission and sources.

4.3 There are six greenhouse gases listed under the Kyoto Protocol which will be covered under the Scheme including carbon dioxide, methane, nitrous oxide, sulphur hexafluoride, hydroflurocarbons and perflurocarbons.

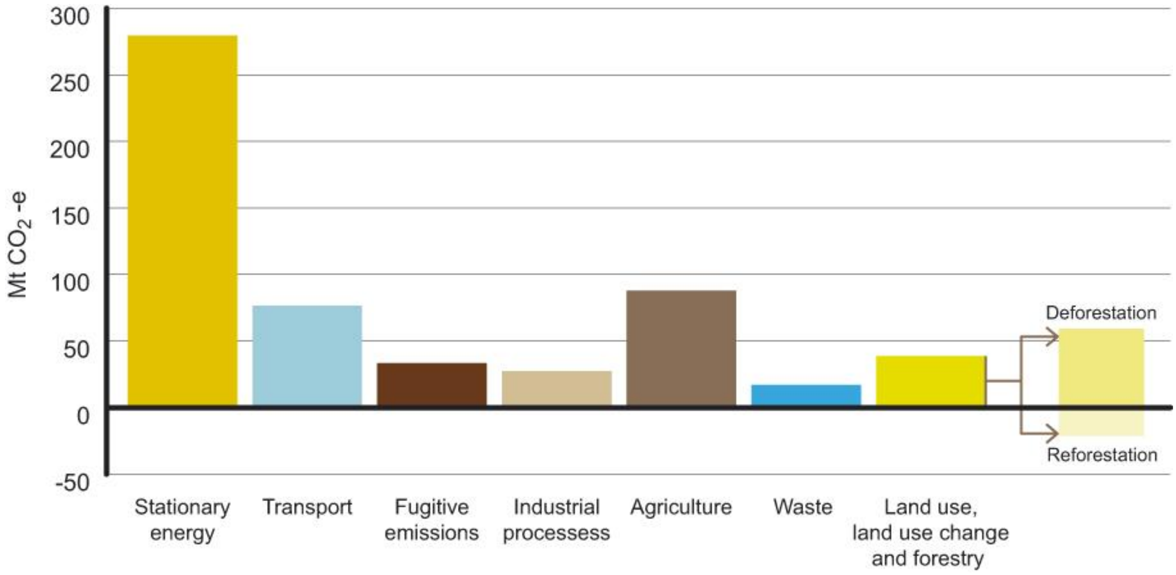
4.4 Carbon pollution permits will be needed for all emissions covered by the Scheme.

4.5 Chart 4.1 shows the contributions of various sectors to the 576 million tonnes of $CO_2$e emitted by Australian entities in 2006.[1]

4.6 It can be seen from the chart that the main cause of emissions in Australia is stationary energy - notably coal-burning power stations.

1 Definitions of the sectors are given in *White Paper*, pp. 6–2 and 6–3.

**Chart 4.1: Australian emissions in 2006**




Source: *White Paper*, p. 6-3.

4.7 The CPRS is proposed to include 75 per cent of Australian emissions and involve mandatory obligations for around 1,000 entities, considered to be the largest emitters in the country.

## The timing of the CPRS

4.8 The Committee notes that very few countries actually have emissions trading schemes in place, namely, the European Union (where the scheme has been roundly criticised for failing to deliver $CO_2$ reduction outcomes) and New Zealand.

4.9 Therefore, central to the debate about whether Australia should introduce the CPRS at this time, prior to Copenhagen, is the issue of should Australia be leading the world, *irrespective* of actions the rest of the world may or may not take.

4.10 The committee notes the Government's statement that 'climate change requires a global response. In forging a global solution, Australia's actions inside and outside international negotiations matter'.[2]

4.11 Originally the CPRS legislation had a commencement date of 1 July 2010.

4.12 In May 2009, the Prime Minister announced a 12 month delay to the commencement date of the CPRS to 1 July 2011.

4.13 The Government stated that the later starting date is necessary 'to allow the Australian economy more time to recover from the impacts of the global recession'.[3]

2 Department of Climate Change, Fact Sheet, December 2008, http://www.climatechange.gov.au/whitepaper/factsheets/pubs/008- australia-committed-to-shaping-a-global-solution.pdf, viewed 12 June 2009.

### *United Nations Framework Convention on Climate Change – Copenhagen Conference*

4.14 In December 2009, the parties to the *United Nations Framework Convention on Climate Change* will meet in Copenhagen to discuss a climate pact to replace the Kyoto Protocol when it expires in 2012. The Copenhagen meeting will include consideration of the trajectory of carbon emission cuts through to 2020.

4.15 It is unclear at this stage whether developed nations will accept deeper cuts than those they have pursued under the Kyoto Protocol for the period 2008–2012. It is also unclear whether key developed nations, notably the United States, will take a legislated national position into the international negotiations.[4]

4.16 Copenhagen will also discuss pledges for richer nations to increase their budgets to pay for climate change adaptation and mitigation, and to enable the transfer of affordable clean-energy technology to developing nations. If progress is forthcoming on these issues of targets and funding, a new pact may come into force on 1 January 2013. If the talks stall, negotiations may stretch to 2010 and beyond.

4.17 The committee received conflicting evidence from witnesses as to whether Australia should pass the CPRS before or after Copenhagen.

4.18 Some witnesses gave evidence that Australia has a responsibility to show the way in international negotiations and that an early lead would resolve business uncertainty. Others questioned the wisdom of legislating an Australian emissions trading scheme before we understand what the rest of the world intends to do to reduce carbon emissions.

### *Evidence supporting legislation before Copenhagen*

4.19 Professor Ross Garnaut had been initially hesitant in supporting the CPRS:

> Senator IAN MACDONALD—…If it [the CPRS] were not modified.., would it still be better than nothing?
>
> Prof. Garnaut—That is a really hard question. Let me say it would be finely balanced.[5]

4.20 After the Government's changes on 4 May, Professor Garnaut said:

> When I was asked by Senator Macdonald and answered that it was line ball, I said that there were three steps the government could take that would

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3 The Hon. Kevin Rudd, 'Carbon Pollution Reduction Scheme: Support in managing the impact of the Global Recession', *Media Release*, 4 May 2009.

4 See Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 1 May 2009, p. 85.

5 Professor Ross Garnaut, *Proof Committee Hansard*, 16 April 2009, p. 52.

> make it substantially beneficial. The first of those measures was to put back on the table the condition of 25 per cent reduction of emissions by 2020. The government has done that, so my assessment is that it now would be clearly a positive for this bill to be passed into law.[6]

4.21 Professor Garnaut in his evidence noted that the diplomatic case for taking a legislated cap and trade scheme to Copenhagen is the need for Australia to restore credibility on the international stage following its initial decision not to ratify the Kyoto Protocol.

4.22 His evidence to the committee included that the priority for Australia at Copenhagen:

> …is that we show that we are prepared to play a full proportionate part in an ambitious global agreement. Australia, as the developed country that would be most damaged by unmitigated climate change, should be taking a lead in shaping that Copenhagen agreement towards an ambitious outcome. If we had legislated the CPRS, that would just increase confidence that we were able to deliver on what we were promising.[7]

4.23 He observed that:

> The proposed legislation to establish an emissions trading system has good elements. The best of them is that it establishes the framework of an emissions trading scheme, the complex legal framework for many institutions and instruments that would need to be part of an ETS. It has taken much work and good work to get the legislation to this point. To now abandon this legislation comprehensively would introduce the chance that no government and parliament would want to try again.[8]

4.24 The Climate Institute also gave evidence that Australia has an important role to play on climate change policy internationally:

> What Australia does at home matters internationally. People look at us very closely. I think it would be wrong to characterise Australia as a non-player in the international talks. What we are doing here is being closely watched in the United States in terms of the emissions trading design and features that we have here.[9]

4.25 The Australian Industry Group (Ai Group) gave evidence that it would support passing 'a better designed CPRS…with the right system.'

4.26 In evidence before the committee prior to the Government's 4 May announcements, Dr Peter Burn of the Ai Group said:

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6 Professor Ross Garnaut, *Proof Economics Legislation Committee Hansard*, 22 May 2009, p 18.

7 Professor Ross Garnaut, *Proof Committee Hansard*, 16 April 2009, p. 48.

8 Professor Ross Garnaut, *Proof Committee Hansard*, 16 April 2009, p. 45.

9 Mr Erwin Jackson, *Proof Committee Hansard*, 1 May 2009, p. 76.

> Another way to put it is to say that even if we got no greater indication of action at a global level than we currently have, but we had a better designed CPRS [emphasis added], we would support that. We are not saying wait until the rest of the world acts; we are saying let us act now but let us do it with the right system [emphasis added]. That system would be one that catered for the range of possible outcomes at Copenhagen, gave strong protections for trade exposed businesses and that provided enough time to get the design right and for business to prepare for the impacts.[10]

### *Evidence against legislation prior to Copenhagen*

4.27 Other witnesses gave evidence of the potential disastrous impact on Australia, including losing its competitive advantage, if it were to take action prior to a global agreement.

4.28 Mr Mitch Hooke of the Minerals Council of Australia gave evidence that:

> …there are no prizes for unilateral action unless it is effective, demonstrable leadership…The only counsel I would give anybody is: do not overstate your own self-importance, do not get lost in the logic of your own arguments and be prepared for a whole stack of movements and developments the like of which you can rarely understand and appreciate.[11]

4.29 Mr Hooke also gave evidence that if Australia sets a carbon price through the proposed CPRS in the absence of an international agreement, Australian companies will be at a competitive disadvantage:

> …Even if the Copenhagen meeting fails, Australian firms will pay $8.5 billion in carbon costs every year from 1 July next year. None of our competitors will confront such costs. The CPRS is not linked to the availability of low-emission technologies. In fact, by imposing a $34 billion burden on Australian businesses in the first four years, it will reduce, if not largely eliminate, the ability of Australian firms to invest in these technologies. It is completely out of step with other schemes being developed around the world. Australian firms will pay the highest carbon costs of any other firms in the world. The results will be lost Australian jobs, stalled investment and a less competitive economy.[12]

4.30 Similar concerns were put forward by ERM Power.

4.31 Mr Trevor St Baker, Executive Chairman, ERM Power, gave evidence that to ensure certainty for Australian business, the CPRS must be aligned in both form and timing with an international agreement. As the process of an international agreement

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10 Dr Peter Burn, *Proof Committee Hansard*, 22 April 2009, p. 40.

11 Mr Mitch Hooke, Minerals Council of Australia, *Proof Committee Hansard*, 22 April 2009, p. 29.

12 Mr Mitch Hooke, Minerals Council of Australia, *Proof Committee Hansard*, 22 April 2009, p. 22.

may take years, Australia should concentrate in the interim on investment in low emission and renewable technologies.

4.32 Mr St Baker said:

> A prematurely legislated Australian CPRS would not deliver certainty whilst ever there were a possibility that amendments might be required to align our scheme with a global scheme. The process of designing the scheme and the timing of such a scheme will start to be determined in Copenhagen at the end of 2009 and will be decided by the major carbon polluters, mainly the USA and EU, and of course in collaboration with China in the longer term. That will not happen until sometime in 2010. The commencement of a global scheme is unlikely prior to the end of the Kyoto scheme in 2013. That is why, prior to the design and introduction of an international global carbon pollution reduction scheme, Australia should concentrate on inducements to investment in new, low-carbon emission power generation, including gas fired generation, similarly to the inducements to investment in renewable generation.[13]

4.33 Dr Richard Denniss, Director of the Australia Institute, also gave evidence against legislating prior to Copenhagen:

> …why is Australia rushing in to have our CPRS legislation passed before we have an international agreement at Copenhagen or beyond? A lot of the uncertainty that we are talking about here is about what is possible, what is going to be agreed to et cetera...One way to get around a lot of this uncertainty about what the world will and will not agree to is to wait until they do or do not agree to it.[14]

4.34 Dr Denniss raised concerns around the setting of targets prior to Copenhagen and the potential negative impact of doing this ahead of an agreed global target:

> This parliament will be signing an open-ended, blank cheque if we pass the CPRS with very low targets and then agree to more ambitious targets at Copenhagen. Taxpayers will have to pick up the difference. We will have to import an unknown quantity of permits from other countries, so we are locking in very timid targets. We are about to go into an international agreement where we do not know what will be the targets, and any shortfall will be made up by taxpayers, of which I am one, so I have a vested interest. If we are to have an emissions trading scheme that is designed to send strong price signals to the people who are polluting I would rather wait to find out exactly what will be our international obligation.[15]

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13 Mr Trevor St Baker, *Proof Committee Hansard*, 28 April 2009, p. 77.

14 Dr Richard Denniss, *Proof Committee Hansard*, 15 April 2009, pp 28–29.

15 Dr Richard Denniss, *Proof Committee Hansard*, 15 April 2009, p. 42.

4.35 Mr Andrew Canion, Senior Advisor, Industry Policy, Chamber of Commerce and Industry of Western Australia, gave evidence that the view of the CCI is that it is imperative that global action is taken. He said:

> What we think matters is that Australian industry is operating within the context of a global economy. It is important that we do not have imposts on our industries that are not equivalent to imposts in other nations.[16]

### *Committee view*

4.36 The committee believes that action to mitigate the effects of climate change requires a global response.

4.37 It is therefore imperative that Australia defer consideration of the CPRS legislation until after an international agreement on greenhouse emissions targets has been finalised.

4.38 Legislative action prior to Copenhagen will have a negative impact on Australia and Australians. The committee does not support such action.

4.39 The timing and form of Australia's response must be in sync with the global response, particularly the targets set by the United States and other developed nations.

4.40 The committee also notes that the Shergold report, commissioned by the previous federal government, proposed the following timetable:

- 2008—a long-term aspirational target would be set and an emissions reporting and verification system established
- 2009—finalisation of key design features and establishment of the legislative basis of the scheme
- 2010—establishment of the first set of short term caps and allocation of permits
- 2011, or at the latest 2012—commencement of trading.[17]

### Recommendation 2

**4.41 The committee recommends that the CPRS legislation not be passed in its current form.**

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16 Mr Andrew Canion, Senior Advisor, Industry Policy, Chamber of Commerce and Industry of Western Australia, *Proof Committee Hansard*, 20 May 2009, p. 3.

17 Prime Ministerial Task Group on Emissions Trading, *Report*, May 2007.

## The mechanism of setting caps

4.42 The Carbon Pollution Reduction Scheme Bill establishes that the national scheme caps will be set in regulations. This section of the report looks at those factors that will influence the setting of the emissions cap for a given financial year.

4.43 Sections 13 to 15 of the Bill set out the procedure for the Minister to follow in setting the annual emissions cap for each financial year.

4.44 It states that the Minister must 'take all reasonable steps' to ensure that regulations stating the national cap for the year beginning 1 July 2015 are made at least five years before the end of the eligible financial year. For each year subsequent to the 2015–16 financial year, the cap should be declared at least five years before the end of that financial year.

4.45 Section 14(5)(a) states that in making a recommendation on the level at which to set the national cap, the Minister *must* have regard to Australia's international obligations under the Climate Change Convention and the Kyoto Protocol.

4.46 Sections 14(5)(b) and (c) state that those factors to which the Minister *may* have regard in recommending the level of the national cap are:

- the most recent report given to the Minister by an expert advisory committee under section 354 of the bill;
- the principle that the stabilisation of atmospheric concentrations of greenhouse gases at around 450 parts per million of carbon dioxide equivalence or lower is in Australia's national interest;
- progress towards, and development of, comprehensive global action under which all of the major economies commit to substantially restrain greenhouse gas emissions and all of the advanced economies commit to reductions of greenhouse gas emissions comparable to the reductions to which Australia has committed;
- the economic implications associated with various levels of national scheme caps, including implications of the carbon price;
- voluntary action to reduce Australia's greenhouse gas emissions; and
- estimates of emissions that are not covered by the scheme.

4.47 The CPRS Bill 2009 includes changes from the exposure draft to the way that scheme caps and gateways will be set.

4.48 First, clauses 14 and 15 of the bill now state that a written statement must be tabled in parliament outlining the minister's reasons for the regulations underlying the scheme caps and gateways.

4.49 Second, the Government has announced that as part of its consideration of 'voluntary action' identified in paragraph 14(5)(c)(iv):

> Additional GreenPower purchases above 2009 levels will be directly recognised…[with] additional GreenPower purchases…measured annually and future caps…tightened on a rolling basis.[18]

4.50 The Explanatory Memorandum to the CPRS bill elaborates:

> The Government has indicated that additional GreenPower purchases will be measured annually and taken directly into account in setting scheme caps five years into the future, on a rolling basis. For example, the 2016-17 cap will be tightened to reflect the difference between 2009 and 2011 GreenPower sales, multiplied by a factor to reflect the emissions saved. This will achieve emissions reductions beyond Australia's national targets as it will be backed by the cancellation of Kyoto units.[19]

### *Setting the cap - the need for certainty*

4.51 The Committee heard evidence that it is important for business to know well in advance the level at which the cap will be set.

4.52 AGL gave evidence to the Committee that:

> Without a doubt, the sooner we see the regulations the better, but, for a company like AGL, the principal decision points for a company investing in energy infrastructure are really what the targets will be. We know what is proposed in the legislation for the first three years and the gateway for 2020. From our perspective, when you think about modelling the carbon price and incorporating that into a business decision, having the certainty around what those targets are is the most critical thing, from our perspective.[20]

4.53 Woodside expressed similar concerns giving evidence that it is important to have 'a sufficient amount of detail' in the legislation rather than in regulations.

4.54 Mr Niegel Grazia of Woodside gave evidence that the long-term, large scale nature of the company's liquefied natural gas investments meant it will have to rely on 'two or three instances' of ministerial discretion for continued assistance.[21]

4.55 The Energy Supply Association, the peak industry body for the stationary energy sector in Australia, told the committee that the CPRS should incorporate rolling scheme caps:

> We believe that the CPRS should also commit to 10 years of rolling scheme caps, followed by a 10-year rolling gateway. The energy industry recognises that the setting of scheme caps and gateways requires a balance

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18 Australian Government, 'Helping all Australians do their bit on climate change', *Media Release*, 4 May 2009.

19 *Explanatory Memorandum*, p. 80.

20 Mr Tim Nelson, *Proof Committee Hansard*, 21 April 2009, p. 12.

21 Mr Niegel Grazia, *Proof Committee Hansard*, 28 April 2009, p. 68.

> between economic efficiency and policy flexibility to allow the government to respond to changes in scientific knowledge and international commitments. However, the government is the only entity that can commit Australia to international negotiations and therefore the government should bear the risk of future scheme caps and/or gateways being inappropriate. With long-lived, capital-intensive infrastructure, the industry cannot be expected to bear this risk.[22]

### *The need for political independence*

4.56 The committee also heard that the task of setting the cap should be the responsibility of an independent statutory authority, not the Minister.

4.57 This view was flagged by the President of the Australian Council of Trade Unions, Ms Sharan Burrow:

> … The more I think about it, the more I think we need an independent monitoring assessment authority—a statutory authority as appropriate. It does seem to me that the work of making sure that the commitments, the transparency, the effort—whether it is decay, the situation of corporations or all of those things—requires an incredibly detailed and scientific base. With due respect, for that to come back to a political authority from any party does not seem to me the way we would run any other major part of the economy…I would urge the committee to consider the role and whether a statutory authority or some other such independent body is not a better way to set Australia up for a scientific base to these considerations, as opposed to the normal cut and thrust of political decision making.[23]

4.58 Some witnesses expressed concern that the CPRS, as proposed, does not have an adequate governance framework.

4.59 Dr Regina Betz of the Centre for Energy and Environmental Markets contrasted the Government's Draft Exposure Bill with the electricity market, which has a clear separation of policy (the Ministerial Council on Energy and COAG), a rule-maker (the Australian Energy Market Commission), a regulator and an organisation responsible for operational aspects. Any party can put forward a proposed rule change at any time, and then a formal process begins. She added:

> I do not think we see anything like that rigour in what is currently proposed for governance for this scheme. The one thing we do know is that, when the scheme initially goes in, we will make mistakes, potentially very significant mistakes. Our ability to correct those is going to be a key part of success or failure.[24]

4.60 Evidence was also given that if ministerial discretion is to be applied effectively in adjusting a trading scheme, it must set a principled standard.

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22 Ms Clare Savage, *Proof Committee Hansard*, 28 April 2009, pp 31–32.

23 Ms Sharan Burrow, *Proof Committee Hansard*, 22 April 2009, p. 2.

24 Dr Regina Betz, *Proof Committee Hansard*, 1 May 2009, p. 64.

4.61 This point was made by Dr Iain MacGill, also a director of the Centre for Energy and Environmental Markets:

> At one level if you are very outcome focused then a great deal of ministerial, hence political, direction can go one way or the other. It might be very productive and allow very important changes to be made in the timescale that might be required. However, in the general sense we look to establish processes that provide guidance on how decisions will be taken with some view as to the boundaries of those. If we look at the national electricity market, there are opportunities for significant political discretion to play out. However, there is a very conscious attempt to establish a process by which you will establish a basis of fairness or appropriateness as to such discretion being exercised.[25]

### *Setting the cap - the need for flexibility*

4.62 The committee heard from some witnesses that there must be flexibility in setting the cap to allow for both a strong international agreement and adjustment to take scientific factors into account.

4.63 Environment Business Australia argued:

> Originally the concept of the CPRS was for it to be a flexible market mechanism. It has lost a lot of its flexibility and market aspect as well. In terms of the nimbleness, I think the five-year gateways may be a problem because we may need to reset those given the science that is coming out. We need to be far more flexible if we do need to set much stricter year-by-year targets for emissions cuts.[26]

4.64 Dr Graeme Pearman, a former Chief of CSIRO Atmospheric Research, gave evidence that:

> …you do not lock in any of the agreements for too long because the uncertainty exists and will solve some of those problems and will understand them better in another year's time and another. At that point in time you do not want to be locked in for 20 years in terms of how you respond.[27]

### *Exceeding expectations*

4.65 The committee also received evidence that in setting the cap, it is important to take account of complementary measures such as energy efficiency initiatives, soil sequestration and investment in renewable energy.

4.66 The Hon. Tom Roper, President of the Australian Sustainable Built Environment Council, gave evidence that:

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25 Dr Iain MacGill, *Proof Committee Hansard*, 1 May 2009, p. 64.

26 Ms Fiona Wain, *Proof Committee Hansard*, 15 April 2009, p. 46.

27 Dr Graeme Pearman, *Proof Committee Hansard*, 15 April 2009, p. 96.

…it is very important in both determining the mix of measures that are being taken and doing a proper sum on how that affects the cap. Let us take the CIE material on buildings. If you effectively, through a series of measures, save 52 million tonnes of carbon in the building area, that will clearly change the way in which you might determine a cap and will also change your estimate of what costs will be. The macroeconomics people really need to examine that.[28]

4.67 Ms Burrow expressed her concern the 2020 cap may underestimate the potential for abatement from complementary measures:

Having that cap to 2020 will deny us the right to actually measure what we are doing. I think, in green building retrofit schemes alone, in the built sector, we can do more. In soil sequestration we could actually take a lot more carbon—indeed, legacy carbon—out of the atmosphere a lot quicker than we will get to do from the ambitions in an ETS.[29]

## Carbon leakage and arguments for assistance for trade-exposed firms

### *Carbon leakage*

4.68 The government has defined carbon leakage as:

The effect when a firm facing increased costs in one country due to an emissions price chooses to reduce, close or relocate production or to close or relocate production to a country with less stringent climate change policies.[30]

4.69 The main argument made for assistance to industry is to address the risk of 'carbon leakage'. In this regard, the government has recognised the need to provide assistance to industry in the *White Paper*. The *White Paper* stated:

Australia's adoption of a carbon constraint before other countries may have a significant impact on its emissions-intensive trade-exposed industries. The Government is committed to providing assistance to these industries to reduce the risk of carbon leakage and provide them with some transitional assistance.[31]

4.70 The issue of carbon leakage was a particular concern of the Senate Select Committee on Fuel and Energy.

4.71 At paragraph 5.111 to 5.113 of the majority Interim Report, it stated:

In conclusion, the majority of evidence received by the committee on the issue of the international competitiveness of Australian industry and carbon leakage can be summed up with the following quote: 'it would be a perverse

28 The Hon. Tom Roper, *Proof Committee Hansard*, 22 April 2009, p. 58.

29 Ms Sharan Burrow, *Proof Committee Hansard*, 22 April 2009, p. 10.

30 *White Paper*, p. F-4

31 *White Paper*, p. 12-1.

> outcome if the implementation of the CPRS in Australia led to a result which added to global emissions.'
>
> ***Committee comment***
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> The committee considers that in the absence of an appropriate global framework the CPRS as currently designed will not sufficiently mitigate the risk of carbon leakage.
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> The committee is of the view that:
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> - EITE assistance should be expanded so that it is based on production rather than on an activity basis;
> - EITE assistance should be maintained at commencement levels until major competitors face comparable carbon costs;
> - The coal mining industry should not be excluded from EITE assistance;
> - Appropriate recognition should be given to those industries that contribute to a global reduction in emissions, such as LNG.[32]

4.72 The committee recognises that there are many ways in which carbon leakage can occur. For example through a company closing its Australian facility and opening a new facility in a country without a carbon price. Alternatively, whereby the Australian producer gradually loses market share to an overseas competitor as a result of Australia introducing a price for greenhouse gas emissions. In this scenario, existing plants may continue to operate but there will be no new investment.

4.73 The committee agrees with the conclusion of the Select Committee on Fuel and Energy that 'it would be a perverse outcome if the implementation of the CPRS in Australia led to a result which added to global emissions'.[33]

### *Evidence of serious concerns*

4.74 Many industry representatives raised carbon leakage as a real and serious concern.

4.75 For example, Mr Andrew Canion, Senior Advisor, Industry Policy, Chamber of Commerce and Industry of Western Australia, gave evidence that his organisation have been advised by its members that the risk of carbon leakage is real and that a rational economic business decision would be to invest where it is the least costly to do so:

> We have been advised by our member companies that the risk of carbon leakage is real and that a rational economic business decision would be to invest where it is the least costly to do so. We have further been advised that there is a risk that, should Australia introduce an emissions trading

32 Senate Select Committee on Fuel and Energy, *Interim Report: The CPRS: Economic cost without environmental benefit*, May 2009, pp 151-152.

33 Senate Select Committee on Fuel and Energy, *Interim Report: The CPRS: Economic cost without environmental benefit*, May 2009, p 151. The statement was originally made by Ms Nicky Cusworth from the Western Australia Department of Treasury and Finance.

> scheme of itself without complementary action internationally, a rational business decision would be to look at those other options. [34]

4.76 Mr Frank Topham, Manager, Government Affairs and Media, Caltex Australia Ltd, provided evidence to the committee that:

> I think under the CPRS carbon leakage will be a very grave threat to Australian manufacturing industries, including oil refining. It is very difficult to quantify at this stage what the exact impact would be.[35]

4.77 Mr Timothy McAuliffe, Manager, Environment and Sustainable Development for Alcoa of Australia provided evidence to the committee that:

> Alcoa believes there are a number of key changes that need to be made to its [CPRS] design to ensure it does not lead to carbon and jobs leakage from the Australian aluminium industry.[36]

4.78 Mr Bradley Teys, Chief Executive Officer, Teys Bros Pty Ltd, gave the following evidence to the committee:

> I just want to make sure that the scheme we put in for the cattle and livestock industry does not in fact reduce our exports so that Brazil, which is 40 per cent less efficient, picks them up and we have carbon leakage.[37]

### *Alternative views*

4.79 Ms Meghan Quinn, a representative from Treasury, gave evidence that:

> A modelling organisation called CICERO, which is a reputable organisation within Europe, estimates that carbon leakage would be under three per cent for the entire Kyoto regime between developed countries and developing countries. Similarly, in the modelling produced in the *Australia's low pollution future* report, we found that, once emissions-intensive trade-exposed industries had been allocated permits under the 90-60 per cent ratio in the *Green Paper*, there was little evidence of carbon leakage in the economic models that we used.[38]

4.80 Other witnesses also questioned the likely extent of carbon leakage:

> But most estimates are that it is quite moderate—in the order of five to 15 per cent. One of the key factors is that these are very capital-intensive industries, so they make decisions on location not only on the prices today but on … whether there will be a carbon price—in 10 or 15 years time…even if countries like China do not have an explicit carbon price

34 Mr Andrew Canion, *Proof Committee Hansard*, 20 April 2009, p. 4.

35 Mr Frank Topham, *Proof Committee Hansard*, 21 April 2009, p. 81.

36 Mr Timothy McAuliffe, *Proof Committee Hansard*, 1 May 2009, p. 25.

37 Mr Bradley Teys, *Proof Committee Hansard*, 28 April 2009, p. 11.

38 Ms Meghan Quinn, *Proof Committee Hansard*, 1 May 2009, p. 86.

> today… there is quite a probability that they will have a carbon price by 2015 or 2020.[39]
>
> The relative magnitude of leakage varies across different models, depending on the assumptions, and it can be somewhere between five per cent and 20 per cent.[40]

### *Assistance to emissions-intensive, trade-exposed industries (EITEs)*

4.81 The government has recognised the need to provide assistance to industry in the *White Paper*. The *White Paper* stated:

> Australia's adoption of a carbon constraint before other countries may have a significant impact on its emissions-intensive trade-exposed industries. The Government is committed to providing assistance to these industries to reduce the risk of carbon leakage and provide them with some transitional assistance.[41]

4.82 The Government proposes to provide free permits to some EITEs. The permits provided will be based on the industry's historic average emissions intensity, avoiding penalising individual firms who are lower than average polluters and retaining an incentive for firms to cut emissions. Assistance will be linked to production: expanding firms will receive an increased number of permits and contracting firms will receive fewer permits. A firm which ceases to operate in Australia will no longer receive permits.

4.83 Firms that are able to produce the same quantity of output with fewer permits than are provided will be able to sell the difference. In effect, they will receive credit for performance better than the baseline. Firms with emissions above the baseline level will have to buy additional permits. To some extent this part of the CPRS operates like a 'baseline and credit' or 'intensity' system, and is subject to some of the criticisms made about such schemes.[42]

4.84 Trade exposure will be assessed based on either having trade share (average of exports and imports to value of domestic production) greater than 10 per cent in any year 2004–05 to 2007–08 or a 'demonstrated lack of capacity to pass through costs due to the potential for international competition'.[43] Emissions intensity refers to emissions relative to either revenue or value added, averaged over the lowest four years from 2004–05 to 2008–09.

4.85 The initial assistance announced in the *White Paper* envisaged permits to the value of 90 per cent of the allocative baseline for activities with emissions intensity

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39 Professor Stephen Howes, *Proof Committee Hansard*, 20 May 2009, p 51.

40 Dr David Pearce, *Proof Committee Hansard*, 16 April 2009, p. 8.

41 *White Paper*, p. 12-1.

42 The operation of 'baseline-and-credit' systems is described and critiqued in Chapter 3.

43 *White Paper*, p. lxxv.

above 2000 tonnes $CO_2$e per million dollars of revenue or 6000 tonnes $CO_2$e per million dollars of value added. Permits to the value of 60 per cent of the allocative baseline would have been provided for activities with emissions intensity of 1000 to 2000 tonnes $CO_2$e per million dollars of revenue or 3000 to 6000 tonnes $CO_2$e per million dollars of value added.

4.86 The *White Paper* suggests that, for example, aluminium smelting and integrated iron and steel manufacturing are likely to qualify for the 90 per cent assistance and alumina refining, petroleum refining and LNG production as likely to qualify for 60 per cent assistance. If the CPRS is extended to cover agriculture, it is likely that beef cattle, sheep, dairy cattle, pigs and sugar cane would qualify for assistance.[44]

4.87 The changes announced by the Government on 4 May 2009 increase these assistance rates for at least five years. Under what the Government refers to as the 'Global Recession Buffer', those firms previously eligible to receive 90 per cent free permits will now receive 95 per cent while those previously eligible for 60 per cent will now receive 66 per cent.

4.88 The 66 and 95 per cent assistance rates will be gradually scaled down over time, by an arbitrary 1.3 per cent a year.[45] Some industries doubt that they will be able to achieve 'carbon productivity' improvements at this rate:

> For aluminium smelting, annual ongoing improvement rates of 1.3 per cent are technologically unachievable. Australia’s aluminium smelters currently are run at or close to benchmark performance levels on an international scale.[46]

4.89 The Committee notes that in New Zealand the phase out of free permits does not start until after 2018.[47]

4.90 The argument for concentrating assistance on the EITEs is that other industries will not be adversely affected:

> …if they are not emissions intensive then the costs they will face will be very low. If they are not trade exposed, that means that all participants in

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44 *White Paper*, p. 12-45.

45 The reduction is 1.3 *per cent*, not *percentage points*. So the rate in the second year is 60*(1–0.13)=59.2 per cent, not 60–1.3=58.7 per cent. This also means the rate will never reach zero.

46 Mr Steve Hodgson, President and Chief Executive Officer, Bauxite and Alumina, Rio Tinto Alcan, *Proof Committee Hansard*, 28 April 2009, p. 127.

47 It then reduces linearly until it reaches zero in 2030; www.climatechange.govt.nz; 'Questions and answers'.

> that industry in Australia will face similar costs and they can raise prices and pass it on to the community.[48]

### *Elaboration on five-yearly reviews of EITE assistance*

4.91 The Government has announced that in conducting the five-yearly reviews of EITE assistance, the Expert Advisory Committee will consider:

> (a) the review of eligibility assessment for activities (e.g. taking into account falls in commodity prices etc as outlined in policy position 12.8 in the *White Paper*);
>
> (b) whether modifications should be made to the EITE assistance program on the basis of whether it continues to be consistent with the rationale for assistance or is conferring windfall gains on entities conducting activities;
>
> (c) the extent to which the Scheme has resulted in an increase in the cost of electricity and the extent of pass through to EITEs;
>
> (d) the extent to which EITE firms are making progress towards world's best practice energy and emissions efficiency for their industry sector;
>
> (e) the future shape of the permit price cap, recognising the need to balance the development of market mechanisms and business certainty;
>
> (f) international developments, including the extent to which Australia has entered international agreements, tangible emissions abatement commitments have been made by countries which compete with EITE industries, and major partners or competing countries have introduced carbon constraints into their own economies; and
>
> (g) whether broadly comparable carbon constraints (whether imposed through an explicit carbon price or by other regulatory measures) are applying internationally, at either an industry or economy-wide level, or an international agreement involving Australia and all major emitting economies is concluded, in which case the Committee would make recommendations to Government with regard to the withdrawal of EITE assistance; this assessment will draw on analysis by an independent expert body (initially the Productivity Commission) of quantitative measures of carbon prices or shadow carbon prices in major economies. [49]

### *Critiques of the free permits to EITEs*

4.92 Criticism of the assistance programme has come from companies who argue it still leaves them disadvantaged relative to international competitors. For example,

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48 Dr Martin Parkinson, *Senate Standing Committee on Economics*, *Proof Committee Hansard*, 18 March 2009, p. 17.

49 Prime Minister, Treasurer and Minister for Climate Change and Water, Media release, 4 May 2009, p. 4.

representatives of the LNG industry gave evidence that the proposed level of assistance is not adequate for their sector:

> As the world's cleanest fossil fuel, with a major role to play in reducing global greenhouse emissions, it is our view that LNG projects should be nurtured rather than constrained. Anything less than a 100 per cent permit allocation until competitor countries are subjected to a carbon cost will disadvantage and tend to constrain Australia's LNG industry.[50]

4.93 Mr Frank Topham of Caltex Australia Ltd presented evidence to the committee concerning the inadequacy of EITE assistance in his sector.

> …we suggest that until overseas competitors have equivalent carbon costs then there should be no effective carbon costs imposed on Australian refineries. Under the CPRS that could be done by way of the allocation of free permits.[51]

4.94 The Minerals Council of Australia presented evidence to the Standing Committee on Economics that most its industry remained unshielded:

> The changes marginally raise the level of support for the now infamous emissions-intensive trade exposed industries, but that shielding is still below that provided or proposed by other nations, severely undermining our international competitiveness. In addition, those changes are simply irrelevant for nine out of 10, or 90 per cent, of Australia's minerals exports, which receive no shielding and, therefore, will face the highest carbon costs in the world—again, that our competitors do not face.[52]

4.95 The coal industry also provided evidence that it was not adequately assisted. The situation of the coal industry is discussed in further depth below.

4.96 Mr Charles McElhone, Manager, Trade Policy and Economics, National Farmers' Federation provided evidence to the committee that the short term impact of the CPRS on the supply chain for the agriculture sector had not been adequately considered:

> Senator CASH—In your opening statement, you commented that the agriculture industry is not covered but affected—in other words, the CPRS is at this particular point in time not going to cover you until 2015. Can I get a better understanding of why you are saying that your industry is affected prior to this time?
>
> …

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50 Mr Robert Cole, Woodside Energy, *Proof Committee Hansard,* 28 April 2009, p. 61.

51 Mr Frank Topham, Caltex Australia, *Proof Committee Hansard*, 21 April 2009, p. 81.

52 Mr Mitch Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Legislation Committee on Economics Hansard (Inquiry into the Carbon Pollution Reduction Scheme Bill 2009 and other related bills)* , 29 May 2009, p. 34.

> Mr McElhone—Basically, if you look at the cost profile of the Australian farming sector, such as the cropping sector, about 45 per cent of our costs are energy or energy dependent. So we are talking about fuel use, electricity use, crop contracting and fertiliser use. All those costs will be affected.
>
> Senator CASH—When you say 'affected', do mean negatively or positively?
>
> Mr McElhone—All those costs will go up. At the same time, it should be acknowledged that with such an internationally exposed sector and, disappointingly from our perspective, a real incapacity to pass on those costs as a result, even small increases in cost are going to have large ramifications on our competitiveness to export. We export about two-thirds of what we produce. From that perspective, we will be affected upfront.[53]

4.97 Other witnesses in their evidence argue that the assistance, especially after the Government increased it in its 4 May announcement, is excessive:

> I think the assistance was already excessive. Of course, it benefits a vociferous and influential group of companies who have spent a lot of time and money to convince the community that action is very expensive and that handing them billions of dollars of free permits is in the public interest. I do not believe it is. Indeed, even before the additional largesse…some highly emitting firms in the 90 per cent bracket actually being better off under the CPRS package than if there was no action on climate change at all… firms with emissions that are below industry average but still much higher than other parts of the Australian economy—but lower than their very high-emitting counterparts—stand to receive more permits than their total emission liabilities…firms will have opportunities to reduce their emissions in light of carbon pricing but will be given the historic industry average.[54]
>
> …we are seeing a lot of innovation at the moment, but it is lobbying innovation, and that appears to be where the returns are in the governance arrangements as they currently stand.[55]

4.98 Other witnesses gave evidence that the extent of free permits to large polluters is unfair. For example, the Committee received over form letters, prepared by the Australian Greens, arguing:

> The CPRS as is stands is a pay-the-polluter scheme, not a polluter-pays scheme. By providing Australia's worst polluters with billions of dollars of compensation in cash and free permits to pollute, the CPRS will protect the profits of Australia's worst climate offenders at the expense of clean industries.

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53 *Proof Committee Hansard*, 15 April 2009, p. 9.

54 Mr Salim Mazouz, *Proof Committee Hansard*, 20 May 2009, pp 44-45.

55 Dr Iain MacGill, *Proof Committee Hansard*, 1 May 2009, p. 67.

> It also unfairly transfers the cost of reducing emissions to industries with less lobbying power and to the community at large. Every dollar of compensation that goes to polluters is a dollar less to assist householders and clean industries.[56]

4.99 Similar points were made in many individual submissions.[57]

4.100 It is noted by the Committee that despite raising their objection to the extent of the issue of free permits, no solution was put forward as to how to address the concerns raised by industry in relation to their potential to be disadvantaged relative to international competitors.

4.101 Some witnesses from the financial sector opined that the proposed assistance in the CPRS would be adequate to address concerns about carbon leakage, so that the impact of the scheme on companies would be manageable:

> We looked at industries including steel, cement, aluminium and LNG. We concluded that the scheme's impact was generally in the order of one to five per cent of company value or a little more under some scenarios.[58]

> …our members believe that transitional assistance is necessary for trade-exposed sectors and consider that the revised arrangements leave exposed companies with negligible financial impacts in the short to medium term. Research by Goldman Sachs JBWere…has shown that the financial impact of the CPRS will be minimal for listed Australian companies.[59]

### *Impact on competitiveness*

4.102 Many industry submissions argued that Australian firms will be unable to compete internationally if they are required to meet the cost of their carbon emissions while foreign competitors in the developing world are not. Ms Belinda Robinson of the Australian Petroleum Production and Exploration Association provided evidence to the Committee:

> It remains the case, even after the Prime Minister's recent announcements, that the industry will be subject to a significant cost burden that is not borne by its LNG competitors—including countries such as Qatar, Algeria, Nigeria, Trinidad and Tobago, Egypt, Brunei, Indonesia, Malaysia, Oman and the United Arab Emirates—or our customers. This means a constraint to growth and a consequent increase in global emissions as less Australian natural gas is made available to the world. We do not believe that this is the

56 *Submission FL1*, p 1.

57 See for example Ms Lindy McMahon, *Submission 89*, p. 1; Mieke Elzer, *Submission 191*, p. 1; and Mr Doug McIver, *Submission 551*, pp 1–2.

58 Ms Elaine Prior, Citi Investment Research, *Proof Committee Hansard*, 20 May 2009, p. 83.

59 Mr Nathan Fabian, Chief Executive Officer, Investor Group on Climate Change, *Proof Committee Hansard*, 20 May 2009, p. 61.

> outcome that should reasonably be expected from any policy that has as its core an objective to reduce emissions.[60]

4.103 Mr Ralph Hillman, Executive Director of the Australian Coal Association, provided the following evidence to the committee:

> Notwithstanding the poorer quality of Indonesian coal, our friends in New Zealand prefer it to Australian coal. Notwithstanding their infrastructure problems, it was because of the flexibility of their mining operation compared with ours which requires massive railways and massive port facilities whereas they can just throw it on a barge and then onto a boat. That is how they stole 15 per cent of our export market. The thing is that coal is everywhere. Most countries have coal and there is a vast range of countries in a position to export it and in a position to beat us on a cost basis, so every cent counts. Of course, every country has its advantages and disadvantages. Australia has superb quality coal. We are a properly regulated economy. We have some very good infrastructure; we have a lot of things going for us, but we also have higher labour costs. Our mines are getting further and further inland from the coast. Our mines in the Hunter Valley, for example, are getting deeper; therefore gassier and more expensive to operate. Our mines in the Illawarra are getting deeper and deeper, gassier and more expensive to operate. So it is a dynamic situation and every little thing you load onto the industry makes it harder for the industry.[61]

4.104 Other witnesses regarded this as overstated, pointing to the operation of the floating exchange rate.[62]

### *Transitional assistance to EITEs*

4.105 As noted above, as well as carbon leakage, the Department of Climate Change justified assistance to EITEs as follows:

> …the government is attempting to smooth the transition for individual firms, rather than just have them take a hit on their profit.[63]

4.106 Some other submitters also explained the need for transitional assistance:

> The draft legislation clearly demonstrates to us an appreciation of the fact that the Australian economy will require a period of transition to become a low-carbon economy. There is also a recognition of the potential

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60 Ms Belinda Robinson, Australian Petroleum Production and Exploration Association, *Proof Committee Hansard*, 30 April 2009, p. 65.

61 Mr Ralph Hillman, Executive Director, Australian Coal Association, *Proof Committee Hansard*, 30 April 2009, p. 79.

62 Dr Richard Denniss, Director, the Australia Institute, *Proof Committee Hansard*, 30 April 2009, p. 51.

63 Dr Martin Parkinson, Secretary, Department of Climate Change, *Senate Standing Committee on Economics*, *Proof Committee Hansard*, 18 March 2009, p. 26.

> competitiveness at threat for some aspects of the Australian industry. We can also see evidence in the legislation that the government has considered the emissions trading schemes in other jurisdictions and has looked to learn from the mistakes and some of the challenges that have been experienced with those schemes.[64]
>
> The overriding consideration for the AWU has been to ensure that the EITE industries most exposed to the impacts of the ETS, and least able to pass on costs associated with participation in the Scheme have the maximum level of assistance during the transition to an international framework for emissions trading (which includes both developed and developing countries) on a true burden sharing basis.[65]

## Additional assistance to the coal mining industry

4.107 Coal mining is excluded from EITE assistance. The *White Paper* provided the following explanation:

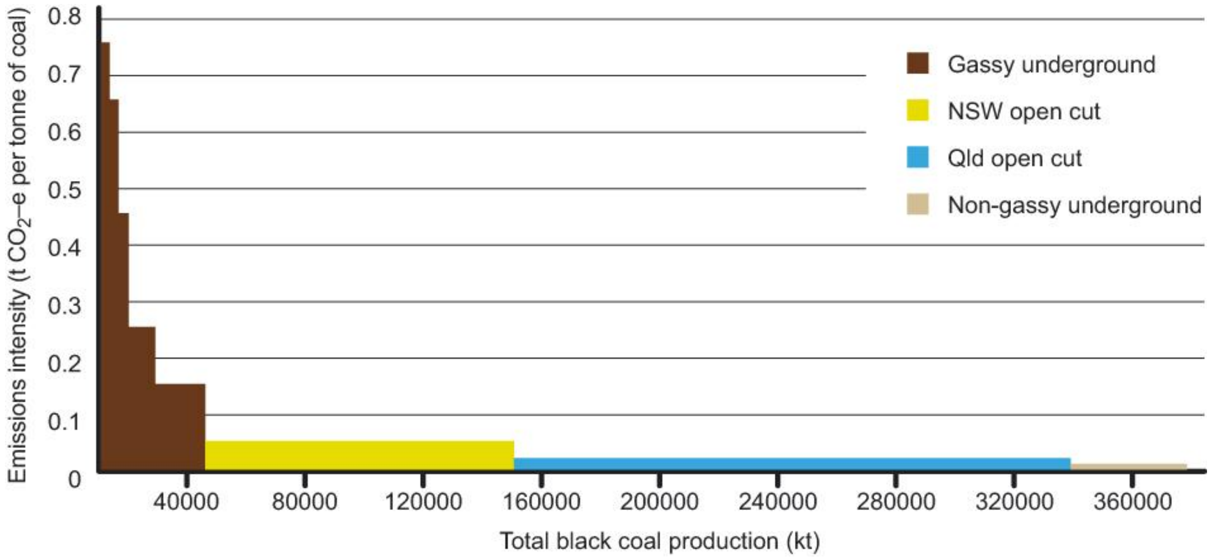
> Since the majority of coal mines are not emissions-intensive, the Government will not provide EITE assistance to the activity of coal mining. (An allocation based on the industry average would lead to the majority of coal mines receiving significant windfall gains.) However, a small number of coal mines are very emissions-intensive and will face a significant cost impact from the Scheme. The Government will allocate up to $750 million from the Climate Change Action Fund to facilitate abatement and assist with the transition of these coal mines.[66]

64 Ms Amanda McCluskey, *Senate Standing Committee on Economics*, *Proof Committee Hansard*, 25 March 2009, p. 48.

65 Australian Workers Union, *Senate Standing Committee on Economics Submission 27*, p. 3.

66 *White Paper*, p. 12-46.

**Chart 4.2: Black coal mine fugitive emissions intensity (2006-07)**




Source: *White Paper*, p 12-46.

4.108 As set out in the *Select Committee on Fuel and Energy Interim Report*:

> Coal is Australia's largest commodity export, earning over $40 billion in 2008. Australia is also the world's largest exporter of coal, exporting over 250 million tonnes in 2008. The black coal industry employs over 30,000 Australians directly and a further 100,000 indirectly. It provides 57 per cent of our electricity generation. When we add in brown coal, that figure rises to over 80 per cent. Coal therefore underpins the security, reliability and comparatively low cost of Australia's electricity supply. In turn, this supports the competitiveness of Australian industry and provides affordable power for Australian households.[67]

4.109 The Government decided to treat coal as a special case. However, this reasoning was not accepted by the black coal industry's representatives:

> We are just asking for fair treatment under the CPRS and under the ET arrangements. Coal clearly meets the white paper eligibility criteria for a 60 per cent permit allocation.[68]

4.110 The black coal industry's response to the issue of 'windfall gains' was to suggest:

> …instead of allocating permits mine-by-mine according to each mine's production you actually recognise the coal industry is different from

67 Mr Burt Beasley, Acting Executive Director, Australian Coal Association, quoted in *Select Committee on Fuel and Energy, Interim Report: The CPRS: Economic cost without environmental benefit*, May 2009, p. 140.

68 Mr Ralph Hillman, Executive Director, Australian Coal Association, *Proof Committee Hansard*, 30 April 2009, p. 181.

> cardboard box manufacturing or aluminium production, you allocate them according to each mine's emissions…[69]

4.111 The Government intends to allocate up to $750 million in targeted assistance to the coal industry, around two-thirds of which will go to 'gassy mines' to assist in the installation of abatement equipment.[70] This is well below the assistance the industry would receive were it to be treated as an EITE.

## Assistance to electricity generators

4.112 The Government will assist electricity generators through the Electricity Sector Adjustment Scheme (ESAS), which will provide an amount of free permits, worth about $4 billion over five years.

4.113 The Energy Supply Association of Australia argued that this is well below the damage they will suffer as a result of the CPRS:

> The government has effectively short-changed the industry by tabling only $3.5 billion in its *White Paper*. This is likely to result in distress across multiple coal-fired assets and it will affect both debt and equity stakeholders... I think you are looking at more like between $10 billion and $20 billion. It is $10 billion, according to two out of the three models by Treasury, to 2020.[71]
>
> The CPRS needs to adequately address the stranding of coal-fired generation assets. A measured transition to full auctioning, as proposed in most other schemes to date, would enable a greater volume of permits to be administratively allocated to affected generators to ensure there is no disproportionate loss of economic value on the sector's balance sheets which would compromise both the ability to refinance existing assets and to make new investments.[72]

4.114 The Association warned that the CPRS was a threat to the solvency of some generators:

> I am concerned that coal-fired assets in particular will find their cost base significantly increased, some by a 200 to 400 per cent increase depending on the $CO_2$ price. In turn that will result in insolvency or near insolvency and certainly a reduced ability to do maintenance. In turn that could lead to reduced energy security or energy supply. It would certainly increase energy security risk.[73]

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69 Mr Ralph Hillman, *Proof Committee Hansard*, 25 March 2009, p. 182.

70 *White Paper*, p. 12-46.

71 Mr Tony Concannon, *Proof Committee Hansard*, 30 April 2009, p. 78.

72 Ms Clare Savage, *Proof Committee Hansard*, 28 April 2009, p. 31.

73 Mr Tony Concannon, *Proof Committee Hansard*, 30 April 2009, p. 46.

4.115 Other witnesses referred to the problems that were being caused for firms wishing to fund investment from international lenders:

> …ERM Power is now marking time before proceeding to arrange finance …The $1.8 billion of finance for these projects will not be obtainable unless lenders and investors are reassured that the Australian electricity sector can maintain its high credit rating. Although the threat of properly made investments in coal fired power stations being stranded does not affect gas fired generators… the remaining international lenders are even more sensitive to changed country risk and particular sector risks.[74]

4.116 The Government argument for the ESAS assistance is that the CPRS:

> …will impose a new cost on fossil fuel-fired electricity generators…relatively emissions-intensive generators are likely to face a greater increase in their operating costs than the general increase in the level of electricity prices…[and] lose profitability…if investors consider that the regulatory environment is riskier…all investments in the sector could face an increased risk premium.[75]

4.117 The justification for ESAS is that a government decision has 'changed the rules' and so the affected companies should be compensated.

4.118 An alternative view is that compensating the generating companies for a reduction in the value of their assets would represent a change to the standard approach of Australian governments.[76] Professor Garnaut commented:

> There is no public policy justification…Never in the history of Australian public finance has so much been given without public policy purpose, by so many, to so few.[77]

## Treatment of voluntary/additional emission reductions

4.119 The committee received hundreds of submissions objecting to the effect of the proposed CPRS on households and businesses' voluntary actions to reduce their greenhouse gas emissions.[78] The submissions highlighted the fact that under the proposed CPRS, households' voluntary actions will not affect the overall level of emissions.

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74 Mr Trevor St Baker, ERM Power, *Proof Committee Hansard*, 28 April 2009, p. 77.

75 *CPRS Bill Commentary*, pp 133-4.

76 Professor John Quiggin, *Proof Committee Hansard*, 28 April 2009, p. 17.

77 Professor Ross Garnaut, cited in 'Oiling the squeaks', *Sydney Morning Herald*, 19 December 2008, p. 25.

78 Households are major emitters, responsible through their energy and fuel use for around 25 per cent of emissions covered by the CPRS. Commercial services and government sectors are responsible for a further 10 per cent as a result of their electricity use.

4.120 In this context, 'voluntary' action refers to things that are done for (or primarily motivated by) altruistic concerns about the environment rather than (just) in response to a price signal.

4.121 For example, electricity consumers who opt to pay more for electricity derived from renewable sources rather than fossil fuels. Another example is the installation of solar panels where the installation costs exceed the savings on power bills.

4.122 For example, under the Government's original proposal, a household that chooses to buy the more expensive option of GreenPower will lead their electricity supplier to make fewer emissions and need fewer permits. This would mean that there are more permits for other polluters to purchase and increase their emissions. As such, the CPRS would act as a disincentive for households, and the many businesses not covered by the scheme, to reduce their carbon footprint. Any voluntary actions that these groups do make will not lead to a reduction in Australia's greenhouse gas emissions.

4.123 This situation was also highlighted in several submissions to the Senate Economics Committee as part of its inquiry into the Exposure Draft of the bill.

4.124 The Economics Committee observed:

> The growing perception that the CPRS negates actions taken by individual households to reduce emissions is eroding support for the scheme. This must be addressed.[79]

### *Views on the voluntary action issue*

4.125 Many individuals and organisations identified a key concern with the proposed CPRS as its failure to take into account the voluntary actions of households, (non-liable) businesses and state and territory governments. The committee received a form letter, prepared by the Australian Greens, from over one thousand submitters stating:

> In addition to setting such a weak 5% target, the CPRS also fails to take into account voluntary emission reductions from the community. The efforts of everyone from householders to State Governments to reduce emissions will be helpful only in reducing the price pressure on polluters. This must be fixed by taking account of community action and all the policies already in place when setting the scheme caps, and using the scheme to drive more ambitious efforts.[80]

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79 See Senate Economics Committee, *Exposure draft of the legislation to introduce the Carbon Pollution Reduction Scheme*, April 2009, p. 73.

80 Form letter, *Submission 5*, see http://www.aph.gov.au/Senate/committee/climate_ctte/submissions/sublist.htm

4.126 A small sample from the hundreds of individual submissions from concerned citizens say:

> It is also of concern that the CPRS, as proposed, does not take into account voluntary emission reductions from the community. The efforts of everyone from householders to State Governments to reduce emissions will be helpful only in reducing the price pressure on polluters. This must be fixed by taking account of community action and all the policies already in place when setting the scheme caps, and using the scheme to drive more ambitious efforts.[81]

> I have recently upgraded my home to be as energy efficient as possible, and have installed solar hot water and a photovoltaic system for renewable electricity. I am dismayed to find that, with the CPRS in its current form, my actions (and considerable money spent!) amount to nothing. They essentially just free up permits for polluters.[82]

> My family and I have gone to considerable effort and expense to reduce our carbon emissions, such as installing a solar water heater and photovoltaic grid interactive solar panels. We think it is scandalous that the government's proposed carbon trading scheme would not take such efforts into consideration, and that they would in fact allow polluters to pollute more. Such efforts should be encouraged by the government, not undermined by such poor policy.[83]

> Ordinary Australians are willing to assist with reducing Australia's carbon footprint and their contribution should not enable big polluters to pollute more, but should make a measurable difference. Otherwise, I fear that householders and small business will fail to see the point in doing their bit for the environment or paying the extra for the CPRS.[84]

> If a cap and trade system is chosen, it must recognise the benefits of voluntary actions and not allow these to do the job of the big polluters. The cap should be lowered by the amount of voluntary reductions achieved by individuals and businesses.[85]

4.127 Several organisations also voiced their concerns.

4.128 The Executive Director of the Australian Conservation Foundation, Mr Don Henry told the Committee:

> I think there is a problem with voluntary action. The Australia Institute has raised it and companies like Origin have raised it, as have many of the green power providers. I think it is really important that people know that

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81 Jo Mead, *Submission 88*.

82 Ms Caitlin McGee, *Submission 66*.

83 Jim and Clare Rourke, *Submission 170*.

84 Ms Fiona Brady, *Submission 65*.

85 Mr Michael Hassett, *Submission 117*.

> what they do can make a difference. It is an important motivating factor, and that is also why we would have the view that other complementary or additional measures are really important here…There are things that we need to be doing, and a price signal through the proposed CPRS, for example, will not be adequate alone, and action is required. You have to ensure, whether it is an individual household or a commercial building doing a retrofit, that they can see the benefit of their action, or are required to act.[86]

4.129 The South Australian Government argued in its submission that the design of the CPRS could be improved by providing for recognition of some forms of abatement action undertaken on a voluntary basis by households and individuals. It identified the purchase of GreenPower and the installation of solar panels as the principal actions which should be recognised. The submission noted three reasons why voluntary action must be taken into account. First, it is important to capture 'a particularly cheap form of abatement'. Second, recognition of voluntary action directly supports investment in clean energy, energy efficiency and jobs. And third, the exclusion of voluntary action means that the commitments of state governments and corporations to voluntary action are no longer encouraged.[87]

4.130 The ACT government also argued in its submission that the programmes of state and territory governments which reduce greenhouse emissions beyond levels required by the CPRS should be recognised in the scheme. The Territory's Environment Minister, Mr Simon Corbell MLA, expressed 'significant concern' that state and territory jurisdictions may not be able to implement more stringent climate change policies. He urged the Commonwealth Government to investigate how these efforts by states and territories can meaningfully contribute to reducing greenhouse gases.[88]

### *A design feature*

4.131 Other witnesses did not view the voluntary action issue as a problem. Dr Frank Jotzo, an economist at the Australian National University, argued in his submission that the alleged oversight of voluntary abatement efforts is not a design fault of the CPRS. Rather:

> Individual action is an integral part of achieving a national emissions reduction target at least cost, and it will be encouraged by rising energy prices. The more individuals do to reduce their greenhouse gas footprint, the easier it will be for Australia collectively to meet any national emissions target. That in turn will make it possible to go for more ambitious national

86 Mr Don Henry, *Proof Committee Hansard*, 22 April 2009, p. 64.

87 Government of South Australia, *Submission 521*, pp 3–4.

88 ACT Government, *Submission 462*, p. 1.

> targets down the track. That of course requires flexibility in being able to ratchet down targets in the future, and the political preparedness to do so.[89]

4.132 In its submission to the Senate Economics Committee's inquiry into the Draft Exposure Bill, the Australian Industry Group opposed the bill's clause guiding the Minister to consider voluntary action in setting the cap:

> Ai Group does not understand what of substance is intended by including among the factors that may be taken into account in setting caps the "voluntary action"… Our understanding is that an ETS (or a carbon tax) would encourage households and businesses to reduce emissions by imposing a price… Ai Group submits that the concept of voluntary action should be removed from the list of factors that can be taken into account in setting caps.[90]

4.133 Mr David Pearce of the Centre for International Economics told the Senate Economics Committee in March this year that far from being a problem, the voluntary abatement issue was in fact a benefit of the CPRS scheme. He argued that voluntary action undertaken by households lowers the demand for permits, which lowers the price of permits and thereby makes abatement less costly for everybody.[91]

### *Possible ways of recognising voluntary emission reductions*

4.134 The committee heard that voluntary efforts to reduce greenhouse gas emissions should be accounted for in a systematic and structured way. Mr Timothy Hanlin, Managing Director of Australian Climate Exchange Limited, stressed the need for a government sponsored voluntary emissions trading scheme. He explained:

> We believe that the CPRS needs mechanisms that, for instance, buy back permits from the market and therefore maintain the cap equivalent to the reductions that are achieved in that voluntary emissions trading scheme. We also believe that at least five per cent additional reduction by 2020 could very easily and conservatively be achieved through voluntary measures. We point to Europe and the fact that post the introduction of an EU emissions trading scheme, Europe has been the largest market growth in voluntary emissions trading of anywhere else in the world.[92]

4.135 Dr Richard Denniss has argued that the Exposure Draft of the CPRS bill should be amended to allow the number of permits to be reduced each year directly in line with the amount of pollution saved by voluntary action. The creation of a secondary market of permits based on households' emissions reductions would enable household emission reduction permits to be exchanged for CPRS permits. To account for difficulties in the accuracy of household emissions measurements, Dr Denniss

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89 Dr Frank Jotzo, *Submission 414*, p. 4.

90 Australian Industries Group, *Submission 90*, p. 5.

91 Mr David Pearce, *Proof Committee Hansard*, 25 March 2009, p. 92.

92 Mr Timothy Hanlin, *Proof Committee Hansard*, 20 April 2009, p. 19.

proposes that secondary market permits be exchanged for CPRS permits at a fixed rate of 2 to 1. If two tonnes of household permits was exchanged for a tonne of CPRS permits, 'it is impossible for the secondary market in household efficiency permits to dilute the value of CPRS permits so long as the measurement error is less than 50 per cent'.[93]

4.136 The Centre for Energy and Environmental Markets at the University of New South Wales has proposed that voluntary action could be recognised through an Additional Action Reserve (AAR). The AAR would annually set aside a proportion of emission units which would be retired if governments, businesses or individuals take emission reduction measures which go beyond a baseline target that emitters are expected to achieve. Through setting aside a fixed proportion of units annually, the Action Reserve would limit recognition of voluntary action and limit potential losses of auctioning revenue. If the allocated emission units are not retired in a given year, they would be returned to the market. The Centre argues that a scheme along these lines would provide a mechanism for 'defined and limited' strengthening of the national emission target which would drive domestic emission reductions rather than potentially draw on international carbon credit markets.[94]

### *The CPRS Bill 2009*

4.137 The CPRS Bill and Explanatory Memorandum have made two broad changes to the Exposure Draft legislation and Commentary in relation to the voluntary abatement issue.

4.138 Evidence was given by Mr Blair Comley, Deputy Secretary of the Department of Climate Change, as follows:

> There are really two broad changes that have been made since the exposure draft. The first change relates explicitly to green power and that is making a commitment by the government that increases in green power above a 2009 baseline would be subtracted from the cap in the future cap-setting process. That is an explicit commitment about green power above and beyond general voluntary action. The second change, which is more a change of explanation and emphasis, is that the explanatory memorandum provides significantly more information than there was in the exposure draft about the way in which voluntary action would be intended to be taken into account. That was really an elaboration of what the government had in mind in the exposure draft bill making it clear that it would monitor a range

93 Dr Richard Dennis, 'Fixing the floor in the ETS: The role of energy efficiency in reducing Australia's emissions', *Research Paper No. 59*, The Australia Institute, November 2008, p. 10.

94 Dr Regina Betz, *Proof Senate Economics Committee Hansard*, 27 March 2009, p. 118. Centre for Energy and Environmental Markets, 'The possible role of an Additional Action Reserve (AAR) in the CPRS to facilitate additional voluntary and policy efforts to reduce emissions', *Concept Note*, p. 1.

> of different indicators of voluntary and individual action and that would feed into the future cap-setting process.[95]

4.139 As noted earlier, additional GreenPower purchases above 2009 levels will be directly recognised when the government sets the caps. Additional GreenPower purchases will be measured annually and future caps will be tightened on a rolling basis. The Explanatory Memorandum to the CPRS Bill states:

> The Government has indicated that additional GreenPower purchases will be measured annually and taken directly into account in setting scheme caps five years into the future, on a rolling basis. For example, the 2016-17 cap will be tightened to reflect the difference between 2009 and 2011 GreenPower sales, multiplied by a factor to reflect the emissions saved. This will achieve emissions reductions beyond Australia's national targets as it will be backed by the cancellation of Kyoto units.[96]

4.140 Mr Comley also gave evidence that the Explanatory Memorandum gives greater detail on the types of voluntary actions that the Government will monitor and take into account when setting scheme caps and gateways.

4.141 The Explanatory Memorandum states:

> A range of other indicators of voluntary action may also be taken into account. As a matter of policy, the Government will monitor annual emissions from the household sector, and will monitor and consider the uptake of certain energy efficiency activities among households and businesses where there are clearly defined business-as-usual benchmarks, and where improvements can be detected. In doing so, the Government will consider trends in the construction or renovation of houses to a star-rating above the minimum required, the use of public transport and the expansion of public transport services, and the uptake of more energy efficient appliances (particularly those that consume a significant proportion of household energy such as water heaters and airconditioners) beyond regulated levels. Action in these sectors could be taken into account by assessing the extent to which the uptake exceeds historical trends, factoring in electricity price changes, regulation and any direct government assistance.
>
> For example, the Government would collect data on the proportion of houses with a 6 star rating that are being constructed, compare this with historical trends and calculate the reduced emissions likely over the full life-cycle of the buildings. This calculation could inform the Government's cap setting decision. Another example could be monitoring the overall fuel efficiency of the passenger vehicle fleet in Australia. The trend improvements in fuel efficiency could then be compared to historical trend improvements, taking account of fuel price changes and other relevant

95 Mr Blair Comley, *Proof Committee Hansard*, 20 May 2009, p. 12.

96 *Explanatory Memorandum*, p. 80.

> factors. Estimates of emissions reductions could then be used to inform the Government's decision regarding appropriate scheme caps and gateways. [97]

4.13 The EM does recognise that it is not possible to list all household and individual actions that could be measured and taken into account by the Minister. It notes that these 'may evolve over time in response to changing carbon prices, technological developments and other economic and social developments'.[98]

### *The Australian Carbon Trust*

4.142 As part of a suite of changes to the Exposure Draft legislation announced on 4 May 2009, the Government proposed to establish an Australian Carbon Trust. The stated purpose of the Trust is 'to help all Australians to do their bit to reduce Australia's carbon pollution and to drive energy efficiency in commercial buildings'.

4.143 The Trust will have two components: a $50.8 million Energy Efficiency Trust and a $25.8 million Energy Efficiency Savings Pledge Fund. The Pledge Fund will enable households to calculate their energy use and retire carbon pollution permits. The Government will establish a website for this purpose and the pledges will be pooled with all contributions tax deductible. The Energy Efficiency Trust will provide funding to cover upfront capital costs for businesses seeking to undertaking energy efficiency measures. Businesses would pass the cost savings back to the Trust at a commercial rate until the borrowed costs (with interest) are repaid.[99]

4.144 A Government Media Release dated 4 May 2009 stated:

> A new website will provide a one-stop shop for individuals and households to simply calculate their energy use and buy and retire carbon pollution permits under the Carbon Pollution Reduction Scheme…The Pledge Fund will be entirely voluntary and contributions to the Pledge Fund will be tax deductible.[100]

### *Responses to these measures*

4.145 The committee sought comment on how effective the Pledge Fund would be in resolving the voluntary action issue.

4.146 Dr Denniss remains a strong critic:

> The proposal that was put forward is bizarre—that is the only way to describe it. The notion that individuals who make decisions to use less energy—be that through transport or in their household—would log on to a

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97 CPRS Bill Explanatory Memorandum, p. 80.

98 CPRS Bill Explanatory Memorandum, p. 81.

99 Once the initial capital cost has been repaid, the business keeps the ongoing cost savings from its investment.

100 The Hon. Kevin Rudd, 'Helping all Australians do their bit on climate change', *Media Release*, 4 May 2009.

website, calculate how much money they had saved on their electricity bill, donate that money to Kevin Rudd and that he in turn would go and purchase a permit from someone that they recently gave it to for free is just inexplicable—bizarre. Add to that the fact that people might have spent extra money of their own on buying a Prius or installing insulation in their house, if they did not get the thing, or installing a solar panel—people are spending their own money. And then, if they save electricity, they are expected to donate money to the federal government. As to the argument, 'At least it is tax deductible now': it was always tax-deductible if you donated it to an environment group who went and purchased the permit. But the idea that the solution to this is to purchase a permit…to pay twice—is just inexplicable.[101]

…

let us just stop the lying to consumers who are picking up the tab through higher electricity prices through the MRET, through higher taxes that are going to be needed to provide business with the certainty they are after and through the fact that we are telling them to go and spend their money on abatement measures that are not going to abate emissions at all.[102]

4.147 Other witnesses also identified the flaw in forcing households to 'pay twice'.

4.148 Mr Russell Marsh of the Clean Energy Council told the committee:

The creation of the energy efficiency savings pledge fund appears to be asking consumers to pay twice for carbon savings—firstly, when they pay to install a certain bit of energy efficiency or renewable energy equipment and, secondly, to have those permits retired from the market. It is not quite clear exactly how that is going to work, but at first glance it appears to be asking consumers to pay twice. There is a particularly strong case to look at retiring permits associated with the installation of solar PV on households. This is a technology that is getting a lot of financial support from the government. There is a rebate scheme—the Solar Homes and Communities Plan—that offers $8,000 to householders to install solar PV on their roofs. The main driver for people to do that, and the main driver for the government to do that, is to reduce carbon emissions. It makes sense to us to reflect that fact by being able to retire the permits that would be the equivalent to that scheme from the CPRS.[103]

4.149 Mr Salim Mazouz from EcoPerspectives disagreed with Dr Denniss' criticisms. He told the committee that the government 'did well' with its announcements in relation to the voluntary action issue. He added:

Essentially, voluntary action has already made a difference and will continue to make a difference in reducing the cost of achieving emissions

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101 Dr Richard Denniss, *Proof Committee Hansard*, 20 May 2009, p. 41.

102 Dr Richard Denniss, *Proof Committee Hansard*, 20 May 2009, p 55–56.

103 Mr Russell Marsh, *Proof Committee Hansard*, 20 May 2009, pp 66–67.

> abatement in Australia. With regard to the reduction to cost, as you can see the whole debate on the Carbon Pollution Reduction Scheme is about how much it will cost. That is why government is not willing to do much more…Agreed, it translates in the first place into reductions in the cost of achieving emissions abatement in the rest of the economy, but nonetheless that makes a real contribution to the ability of Australia to move ahead with significant emissions cuts through time.[104]

## Other design flaws

4.150 Other problems with the CPRS design that influence particular industries have been identified.

4.151 Chapter 5 of the report discusses the transition from the ETS in New South Wales to the CPRS, which may mean that operations currently making a valuable contribution to reducing greenhouse gases by using otherwise wasted methane from coal seams to generate power may no longer be viable.

### *Abatement activities unrecognised*

4.152 The treatment of biochar is discussed further in Chapter 6.

4.153 The Select Committee on Fuel and Energy in its Interim Report has referred to cases where the CPRS does not recognise activities that contribute to reducing greenhouse gases:

> The committee considers that what matters is effective and cost effective action to reduce global greenhouse gas emissions. The accounting rules under the Kyoto Protocol are a secondary consideration. As such the committee is of the view that the design on any Australian initiative to contribute to global efforts to reduce greenhouse gas emissions should recognise and encourage all effective and efficient ways to reduce global greenhouse gas emissions irrespective of whether or not they are recognised under the Kyoto Protocol accounting rules.[105]

### *Treatment of landfill*

4.154 The Committee heard that the landfill industry was being treated unfairly. It appeared to be the only industry that is being punished for past sins:

> …the core issue of the CPRS legislation for the waste sector is the inclusion of emissions from waste deposited prior to the implementation of the scheme. The industry calls this legacy waste emissions. This is the most vital issue as waste decomposes over decades in a landfill and as such the

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104 Mr Salim Mazouz, *Proof Committee Hansard*, 20 May 2009, p. 56.

105 Senate Select Committee on Fuel and Energy, *Interim Report: The CPRS: Economic cost without environmental benefit*, May 2009, p. 76.

> inclusion of legacy waste emissions in the scheme from 2008 and onwards renders landfill owners liable for emissions which could emanate from waste that was deposited up to 50 years ago.[106]

4.155 This creates inequities between long-standing sites and new sites with no such legacy wastes. Furthermore, taxing waste disposal practices from decades ago does not influence future behaviour as the scheme aims to do. The industry suggested amending the treatment of landfill so that old landfill sites were given credit for collecting methane emissions.

4.156 The Government has now announced that the landfill industry will not be liable for emissions generated by waste dumped in the past. This has been applauded by the Australian Industry Group as a 'victory for common sense'.[107]

### *Western Australia*

4.157 Evidence was given that the CPRS is also fundamentally flawed in that it fails to take into account the special circumstances of Western Australia. The rest of the country is part of an integrated national electricity market (NEM) whereas Western Australia is isolated and reliant on a small number of gas suppliers. This means much of the Treasury analysis assuming pass-through of higher costs is inapplicable to the WA market:

> Being in the isolated south-west interconnected system, or the SWIS, creates additional problems and concerns as opposed to being part of the NEM. It becomes more difficult for WA to dispatch renewable energy while ensuring that baseload power supplies are guaranteed.[108]

> In Western Australia we do not have a gross pool energy market… energy is [mostly] traded bilaterally; that is, in long-term contracts...The effect that has is that there is then no capability of passing through the respective emissions intensity cost [in] a spot market as there is in the NEM. Basically, the generator who has locked in prices anywhere in the last five to 10 years has to carry those costs going forward.[109]

## The interim price ceiling

4.158 The *White Paper* envisages a price ceiling on permits to apply for the first five years. The ceiling will be $40 a tonne, rising by 5 per cent a year in real terms. This will be implemented by the issuance of additional permits as required. It is

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106 Mr James Spedding, Secretary, Australian Landfill Owners Association, *Proof Committee Hansard*, 22 April 2009, p. 44.

107 Australian Industry Group, Media release, 14 May 2009; *Australian Financial Review*, 15 May 2009, p. 4.

108 Mr Andrew Canion, Chamber of Commerce and Industry of Western Australia, *Proof Committee Hansard*, 20 April 2009, p. 16.

109 Mr Shane Cremin, Griffin Energy, *Proof Committee Hansard*, 20 April 2009, p. 57.

controversial as it increases the risk that Australia will either not meet its emission reduction targets or taxpayers will be forced to incur an uncertain cost of buying international permits and makes it harder for the Australian scheme to be linked to overseas schemes.[110]

4.159 Dr Regina Betz, an expert on European emissions trading, believes the limit is inappropriate, and probably unnecessary:

> The fear that the price is going to get too high seems to be going through the whole legislation, whereas the fear that the price is not going to be enough to actually drive any change is somehow not really included. As to setting the price cap, I was trying to find out what was the rationale behind the $40 that it was starting with. It is very difficult to get any information. If such figures are set wrongly we will actually not end up with the emission reductions we want to achieve and we might really end up with problems in the budget because the Kyoto target or the future international target is going to be met and then it is going to be met based on buying a certain amount of units or CERs from outside.[111]
>
> If you are linking internationally, you already have a price cap so the question is: do we need a price cap at all if we have a link to the Kyoto mechanisms? [112]

4.160 On 4 May 2009 the Government announced that in addition to the ceiling, for the first year of the CPRS' operation, permits would be issued at a fixed price of $10 a tonne. The idea of starting the scheme with a brief period of fixed price permits was raised in the *Garnaut Review*, although Professor Garnaut's suggestion was for a price of $20, much closer to the predicted market price.[113]

## Adequacy of assistance to households

4.161 Ensuring that low-income families are not worse off while still maintaining price incentives for them to economise on emissions-generating activities is critical to the design of an effective emissions reduction policy.

4.162 Assistance to households is premised on the notion that, while most households will be able to adjust their behaviour to minimise the impact of a carbon price on their standard of living, those who have a low capacity to absorb or avoid the effects should be provided with direct assistance.[114]

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110 This view was put in submissions on the *Green Paper* by, for example, BP Australia and environmental groups; *White Paper*, pp 8–33, 34.

111 Dr Regina Betz, *Proof Committee Hansard*, 1 May 2009, p. 66.

112 Dr Regina Betz, *Proof Committee Hansard*, 1 May 2009, p. 66.

113 *Garnaut Review*, p. 350.

114 *White Paper*, Executive Summary, p.3.

*The Government's proposal*

4.163 The *White Paper* released by the Government outlined a household assistance package based on an initial assumed carbon price of $25 a tonne, projecting an increase in the average household's electricity bill by around $4–5 per week and gas and other household fuel bill by $2 per week (assuming no behavioural response).[115] The *White Paper* did not expect the introduction of a CPRS to affect petrol prices (see below).

4.164 The Government's proposed assistance includes the following:

- pensioners, seniors, carers and people with disability will receive additional support, above indexation, to fully meet the expected overall increase in the cost of living flowing from the scheme;
- other low-income households will receive additional support, above indexation, to fully meet the expected overall increase in the cost of living flowing from the scheme;
- around 89 per cent of low-income households (or 2.9 million households) will receive assistance equal to 120 per cent or more of their cost of living increase;
- middle-income households will receive additional support, above indexation, to help meet the expected overall increase in the cost of living flowing from the scheme. For middle–income families receiving Family Tax Benefit Part A, the Government will provide assistance to meet at least half of those costs;
- around 97 per cent of middle-income households will receive some direct cash assistance. Around 60 per cent of all middle-income households (or 2.4 million households) will receive sufficient assistance to meet the overall expected cost of living increase; and
- motorists will be protected from higher fuel costs from the scheme by 'cent for cent' reductions in fuel tax for the first three years.[116]

4.165 Fixing the CPRS permit price at $10 in the first year would result in the permit auction raising $5 billion rather than $12 billion expected if the permit price was $25. This would be insufficient to fund the initially planned assistance, but presumably a lower amount of compensation would be acceptable as the price impacts would also be lower.

4.166 In addition, the Government's plan involves additional payments to pensioners, seniors, carers and people with disabilities of around 1½ per cent and additional support to low- and middle-income households, through increases in the

115 *White Paper*, p. 17-2; Treasury (2008, p. xv).

116 *White Paper*, Executive Summary, p. 4.

low income tax offset, family tax benefits and dependency tax offsets and a transitional payment of $500 for some low-income singles.

4.167 There was broad consensus in the evidence given to the Committee that some sort of assistance should be paid to support low income households who are less able to adapt on their own:

> …there should be appropriate compensation for households. It is a value judgement as to how far you should go in that respect, where the money is going to come from to pay for that and what the opportunity cost of doing it is.[117]

> We regard energy efficiency as critical to both mitigation and adaptation, and we believe that there ought be a coordinated set of policies that support households, especially low-income groups…[118]

4.168 Professor McKibbin suggested that the assistance should be provided in a different form:

> I do not like the word 'compensation'. Let us preserve the balance sheets of households who have to change the way that they use energy and have to have innovations on their energy efficiency front…I believe that there should be large scale allocation of free long-term permits to those industries and households who are most affected.[119]

*Ongoing offset assistance versus transitional payment*

4.169 The benefits of providing assistance to certain cohorts in society (such as low income households) by increasing benefit payments rather than, for example, providing a rebate of electricity charges, were discussed during the inquiry. Professor John Quiggin said:

> I think compensation to households is desirable provided that it is given on a lump-sum basis. The point of any price change is that there is a benefit to it in terms of the increased price that some people receive and a cost.[120]

4.170 Professor Quiggin emphasised the importance of using price signals, rather than offsets, to drive behavioural change.

> For example, supposing that the price of electricity doubles and you receive a cheque in the mail…you do not go out and spend that money on more electricity. The money is available to be spent on anything you like. The sensible thing to do is to allocate your spending to things that have become relatively cheaper. That is the way people typically respond to relative price changes over time, so we see that, even though incomes are rising,

117 Ms Heather Ridout, Australian Industry Group, *Proof Committee* Hansard, 22 April p. 22.

118 Mr Tony Westmore, ACOSS, *Proof Committee Hansard*, 21 April 2009 p. 129.

119 Professor Warrick McKibbin, *Proof Committee Hansard*, 16 April 2009 p. 35.

120 Professor John Quiggin, *Proof Committee Hansard*, 28 April 2009 p. 21.

> consumption of things that have got a great deal more expensive tends to fall…
>
> One of the features of demand for energy in general is that it is highly inelastic in the short term but elastic in the long term. If you simply raise the price, people sensibly are not going to turn their fridges off, but next time they buy a fridge they will be looking for a four-star fridge rather than a two-star fridge.[121]

4.171 Mr Tony Westmore, of the Australian Council of Social Services (ACOSS) pointed out the relative inability of low income households to respond to price signals saying:

> They are generally less well equipped to cope, to adapt, to relocate. Low income households are also likely to bear the brunt of our responses to climate change, particularly those that increase the costs of essential goods and services… The need to 'reduce carbon pollution at the lowest economic cost' is complex… The issue begs other questions—the lowest economic cost for whom and when, and for which economy?[122]

4.172 Mr Westmore did, however express ACOSS's broad support for the assistance measures provided for by the Government saying:

> Our principal constituency is low-income households, and we are reasonably satisfied at this stage that the government has done what it can.[123]

*Petrol Prices*

4.173 The impact of the CPRS on petrol prices will be offset by cuts in other fuel taxes over three years.[124] This transitional assistance has been criticised by many economists who believe that imposing a carbon price on motorists and then immediately offsetting it with an excise reduction is ineffective in changing behaviour.

4.174 Caltex Australia argued:

> …the excise reduction provided for motorists and certain other fuel users under the CPRS will make the inclusion of these users environmentally ineffective for many years yet it will create massive churn in emission permits. As a consequence of that ineffectiveness, due to the excise reduction, we suggest that private motorists and some commercial users be excluded from the CPRS…[125]

121 Prof John Quiggin, *Proof Committee Hansard*, 28 April 2009 pp 21-22.

122 Mr Tony Westmore, ACOSS, *Proof Committee Hansard*, 21 April 2009 p. 128.

123 Mr Tony Westmore, ACOSS, *Proof Committee Hansard*, 21 April 2009 p. 130.

124 *White Paper*, Executive Summary, p. 4.

125 Mr Frank Topham, Caltex Australia, Proof Committee Hansard, 21 April 2009, p. 78.

4.175 By 2025, petrol suppliers will have purchased $17 billion in permits and charged them back to customers and the cumulative emissions from petrol will be the same, or slightly higher, as without the CPRS. However, there may be some advantages in fuel suppliers participating in the scheme, including establishing the administrative mechanisms required to determine and allocate liabilities for liquid fuels. Further, coverage ensures that transport emissions are included within the scheme cap. If transport emissions grow, more abatement will be required in other sectors of the economy.

4.176 Mr Blair Comley from the Department of Climate Change gave evidence of the impact of the CPRS on fuel prices and the scheme's impact on the cost of carbon over time:

> On the question of fuel, the reduction in the price incentive for fuel in the first three years will reduce the signal for emission reduction in that area and, other things being equal, will lead to a higher overall cost associated with meeting a particular target. The extent of that overall cost depends on how much you think people would have changed their behaviour as a response to that price signal, because you have effectively shifted that to the rest of the economy as a result.
>
> Most of the studies of transport demand show that at least in the short term they are relatively unresponsive to changes in price. The responsiveness or the so-called price elasticity over the longer term tends to be higher and therefore it is important that the longer term price signal is such that people can make that choice. So when people are coming to replace a car or decide where they live or make larger investments at the government scale on public transport they take account of that forward-looking carbon price. So in the short run the relative efficiency costs of muting that transport signal are relatively low because of that unresponsiveness, but it is important to have that long-term price signal when people have more opportunities to change the way in which they go about things.[126]

## Implications for jobs

4.177 A major concern about the CPRS is that it will lead to large job losses. (There is a discussion about modelling of aggregate and regional employment consequences in Chapter 2. This section concentrates on evidence provided by individual firms.)

4.178 Mr Bradley Teys, Chief Executive, Teys Bros, provided evidence to the committee of possible impacts on his company, which operates in the meat processing sector:

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126 Mr Blair Comley, Department of Climate Change, *Proof Committee Hansard*, 1 May 2009 p. 90.

> We would probably have to halve the plant from its current level of production…We have got currently close on a thousand people working there, so I guess you could take 400 of those out in that area.[127]

4.179 Mr Joe Marushack, President, ConocoPhillips, provided evidence to the committee on potential impacts on jobs in the LNG sector:

> Mr Joe Marushack, President, ConocoPhillips The negative effect of the proposed scheme on the international competitiveness of the Australian LNG industry has the potential on the one hand to cost Australian jobs…[128]

4.180 Mr Steve Hodgson, President and Chief Executive Officer, Bauxite and Alumina, Rio Tinto Alcan, provided the following evidence to the committee in relation to the alumina sector and other emissions intensive trade exposed industries:

> The CPRS as it stands disproportionately impacts emissions-intensive trade-exposed industries, unnecessarily affecting Australian jobs. By our analysis, the scheme before 2020 risks the following: closure of coalmines; halting expansion of value-adding alumina refining; putting aluminium smelters into survival mode; and stopping the demonstration of emerging industrial scale low emissions technologies. Most of these impacts will be felt in regional Australia.[129]

4.181 Mr Geoff Plummer, Chief Executive Officer, OneSteel, gave the following evidence to the committee:

> I would be certain there would be job losses. In the short term, unfortunately, I think it would be in the hundreds of jobs because we would lose our competitive position. In the longer term, if we lose our ability and our capacity to reinvest to ensure those jobs, it would be more than that.[130]

4.182 Mr Ralph Hillman, Executive Director of the Australian Coal Association, gave the following evidence to the committee in relation to the black coal industry:

> We are forecasting mine closures, shortened mine lives and job losses.[131]

4.183 In his evidence to the committee, Mr Chris Leon, Chair, Cement Industry Federation, noted the possible regional impacts of any job losses:

> The prognosis and why it really concerns me is that the cement industry is characterised by a lot of plants that really are the mainstay of a number of regional centres. In places such as Kandos or Railton, the town is in fact the

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127 Mr Bradley Teys, Teys Bros., *Proof Committee Hansard*, 28 April 2009, p. 5.

128 Mr Joe Marushack, President, ConocoPhillips, *Proof Committee Hansard*, 28 April 2009, p. 100.

129 Mr Steve Hodgson, President and Chief Executive Officer, Bauxite and Alumina, Rio Tinto Alcan, *Proof Committee Hansard*, 28 April 2009, p. 126.

130 Mr Geoff Plummer, Chief executive Officer, OneSteel, *Proof Committee Hansard*, 22 April 2009, p. 14.

131 Mr Ralph Hillman, Australian Coal Association, *Proof Committee Hansard*, 30 April 2009, p. 180.

> plant. I really worry as, frankly, the huge social impact on those towns will be devastating. That is why I think it is very, very unfortunate when you get to the point of those plants shutting down. Certainly the social cost will be huge.[132]

*Green jobs*

4.184 Some witnesses gave evidence of the potential for growth in green jobs. There was evidence given however that many of these jobs would come from a greening of traditional industries, rather than jobs growth in new green industries:

> …there are very significant opportunities for enterprise and employment, provided a signal is sent to assure people who might be prepared to make those investments and take people on—that there is a future for them. I do think there is going to be a transition, and I do think there is going to be some time where communities go through some changes, but there have to be huge chances for employment.[133]

> In the main we do not see there is a dramatic shift from blue collar skills to 'green collar' skills. A tradesperson doing maintenance on a wind turbine for a wind generation farm would have the same skill sets to do a gear box on a coal crusher.[134]

> The model actually has rapid growth in green jobs...[135]

4.185 Other industry representatives gave evidence that the net impact on employment was difficult to estimate:

> They recognise that there could be positives to employment from the CPRS. We need to make that clear. It opens up new business opportunities and avenues. In that regard it should be seen as a positive as it could be a driver of growth. At the same time we do not know its negative consequences, how those two will play out and the balance that will come from it. It is difficult to tell.[136]

*Regional impacts and retraining*

4.186 There will be regional implications of the CPRS.

4.187 Employment will be weaker than otherwise in regions where there is an over-representation of emissions-intensive industry. Frontier Economics gave

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132 Mr Chris Leon, Chair, Cement Industry Federation, *Proof Committee Hansard*, 30 April 2009, p. 52.

133 Mr Tony Westmore, Australian Council of Social Service, *Senate Standing Committee on Economics Proof Committee Hansard*, 23 March 2009, p. 24.

134 Mr Dave Oliver, Australian Manufacturing Workers Union, *Proof Committee Hansard*, 22 April 2009, p. 7.

135 Mr Danny Price, Frontier Economics, *Proof Fuel and Energy Select Committee Hansard*, 2 April 2009, p. 18.

136 Mr Andrew Canion, Chamber of Commerce and Industry of Western Australia, *Proof Committee Hansard*, 20 April 2009, p. 2.

evidence to the Select Committee on Fuel and Energy that the Hunter, Illawarra, central Queensland and La Trobe regions have been suggested as areas that may be particularly affected.[137]

4.188 Nonetheless, there is a case for some assistance programmes to assist some workers to move from brown jobs to green jobs. In some cases this may involve retraining. In other cases it may involve helping them move from regions dominated by high-emissions industries to regions with low- or no-emissions industry.

## International linkages

4.189 A number of witnesses and submitters gave evidence of the importance of developing a domestic climate change response which facilitates international linkage and supports a healthy global permit trading market.

4.190 As noted in Chapter 3, this is often regarded as an advantage of an ETS over some alternative approaches.

4.191 Most evidence centred around the impact of trading in international permits on the domestic permit price, the extent to which Australia would need to purchase international permits to meet its international obligations and the importance of having a domestic scheme to demonstrate Australia's commitment to international action.

### *Impact on Domestic Permit Price*

4.192 Dr Frank Jotzo, Deputy Director of the ANU Climate Change Institute, has analysed the impact of international trade in permits on domestic prices. He is critical of restricting or excluding the export of permits, saying that:

> Precluding permit exports is in many ways akin to banning any other exports from Australia – if goods that would have been exported are not allowed to be exported, this reduces demand for them and thereby reduces their domestic price. But governments, with good reason, rarely ever ban exports because exporting goods bring many economic benefits, even if domestic prices of export commodities are higher than they would be under autarky.
>
> Integration in international carbon markets is a logical step to take in line with Australia's open trading and investment regime. Openness to international market is a proven recipe for economic success, and has helped bring Australia economic prosperity in the past. The same principles apply to climate policy. Australia should look to establish full linkages with emissions trading schemes in other countries, to the extent that the schemes

137 Mr Daniel Price, Frontier Economics, *Proof Select Committee on Fuel and Energy Hansard*, 2 April 2009, p. 19.

> are compatible in their rules and have mutually acceptable levels of ambition.[138]

4.193 Dr Jotzo also pointed out that the restriction contained in the CPRS on the use of Australian permits in overseas schemes, which effectively prevents the sale of Australian Assigned Amount Units to other countries:

> …means that there could be a lower permit price in the Australian market than in international carbon markets. While this would 'protect' domestic emitters from higher carbon prices, it would mean that abatement action in Australia would remain inefficiently low. Some relatively low-cost opportunities to reduce emissions, and to sell the freed-up permits in overseas markets, would be foregone.[139]

4.194 Professor Warwick McKibbin gave evidence against trade in permits proposed in the CPRS, saying:

> How do they try to minimise costs in the CPRS? There are two ways. One is that you allow permits to come in from overseas so that if you can buy a permit, either a clean development mechanism permit under the Kyoto Protocol or you bring in a permit from another market, you can buy that instead of cutting your emissions. That is one way of minimising the costs. If it does become too expensive in Australia to hit our target we can go offshore. I do not like that strategy because once you bring those assets into the Australian market you have undermined the credibility potentially of the Australian market. It would be as if we brought in foreign currency into the Australian financial system, because we are not in control of the compliance and enforcement mechanisms. I do not like that cost smoothing strategy that is in the CPRS.[140]
>
> On a global carbon trading system you do not know, for example, who has actually done the abatement and where to validate these permits. You will get at the border a permit that says this is a unit of carbon coming from somewhere and we can trade that in the Australian market. I do not think that there is enough control.[141]

4.195 In terms of the evidence given to the Committee, the majority of witnesses and submitters were supportive of retaining enough flexibility to engage in international trade in permits in the future, albeit with differing views on how to minimise the potential risks to domestic permit prices.

### *Meeting international obligations*

4.196 The Government has stated that the CPRS would give effect to Australia's obligations under the United Nations Framework Convention on Climate Change and

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138 Professor Frank Jotzo, *Submission 414*, p. 5.

139 Professor Frank Jotzo, *Submission 414*, p. 5.

140 Professor Warwick McKibbin, *Proof Committee Hansard,* 16 April 2009, p. 32.

141 Professor Warwick McKibbin, *Proof Committee Hansard*, 16 April 2009, p. 38.

the Kyoto Protocol.[142] On 4 May 2009, the Prime Minister, the Hon. Kevin Rudd MP, announced that Australia will commit to:

> …reducing Australia's carbon pollution by 25 per cent below 2000 levels by 2020 if the world agrees to an ambitious global deal to stabilise levels of CO2 equivalent at 450 parts per million or lower...

4.197 The Prime Minister also noted that:

> Up to 5 percentage points of this target could be met by purchasing international credits, such as avoided deforestation credits, using CPRS revenue no earlier than 2015.[143]

4.198 Dr Betz and Professor Jotzo gave evidence that:

> The presumption that Australia would not meet its reduction targets through domestic mitigation alone is supported by the Australian Treasury's modelling, where all main scenarios have Australia as a net buyer in overseas markets in 2020, assuming permit prices only somewhat below the proposed price cap. This would seem plausible given that from past trends in Australia's national emissions, a significant amount of effort would be needed to achieve even the least ambitious of the national target commitments.[144]

4.199 Dr Denniss gave evidence that:

> Given that there is no limit on the capacity of domestic polluters to import permits to meet their own targets in the CPRS but there is a prohibition on the export of credits to other countries, there is obviously the potential for a direct benefit to domestic polluters but a potentially significant impact on Australia's current account deficit and, in turn, on our exchange rate. As such the potential for a large demand for imported credit should not go unconsidered.
>
> …
>
> It is also important to highlight the risk to the Commonwealth budget. There are a number of risks. Again, one that does not appear to have been very much considered is if we agree to five to 15 per cent targets for the CPRS and then we sign up to an international agreement that asks us to go beyond that—say 20 or 25 per cent. Once we have committed to a CPRS target of 15 per cent, if there are any more stringent international obligations the difference will have to be bought. It will have to be imported, again with permits and completely from consolidated revenue. Taxes on nonpolluters will be required to purchase any permits required to

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142 *CPRS Bill Commentary*, p. 14.

143 The Hon. Kevin Rudd, *Media Release*, New measures for the Carbon Pollution Reduction Scheme, 4 May 2009.

144 Professor Frank Jotzo, *Submission 414: Attachment B*, p. 12.

> make up the difference between the very low targets in the CPRS and the potentially higher targets that come out of the Copenhagen agreement.[145]

4.200 The Australian Conservation Foundation gave evidence that :

> …both a qualitative cap and a quantitative cap. With respect to the quantitative cap, we see that the action within Australia in terms of the abatement effort should be largely driven within Australia. For example, let us take the 15 per cent target. What we are doing there is reducing emissions by 15 per cent on 2000 levels, using the government's base line. We believe that the majority of that 15 per cent abatement should come from action within our own country. In effect, when you do those sums, you would not see more than 10 per cent of international permits being brought in if we had a 15 per cent cap.[146]

4.201 Mr Andrew Canion, from the Australian Chamber of Commerce and Industry, gave evidence that:

> The real problem is that there are not a lot of other international schemes out there at the moment, so the possibility for linkages is largely theoretical at this stage.[147]

145 Dr Richard Denniss, *Proof Committee Hansard*, 25 March 2009, pp 75–76.

146 Mr Owen Pascoe, ACF, *Proof Committee Hansard*, 22 April 2009, p. 63.

147 Mr Andrew Canion, *Proof Committee Hansard*, 20 April 2009, p. 14.