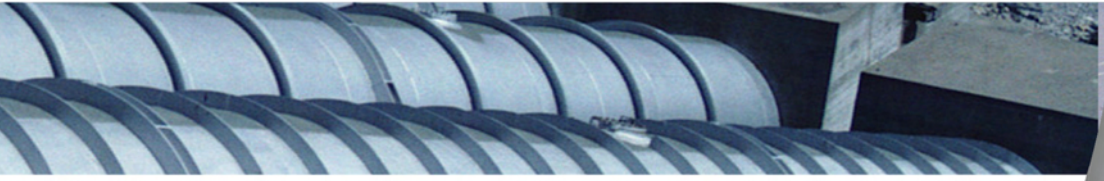
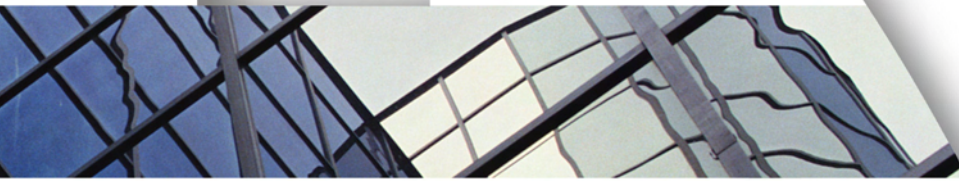
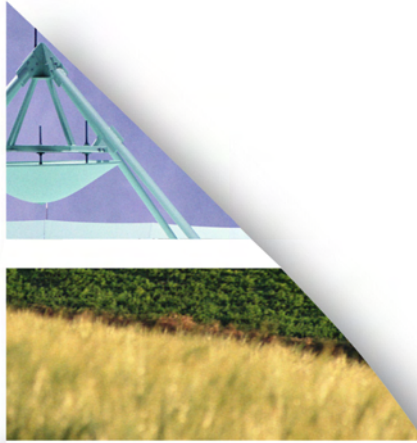




**AUSTRALIAN
INDUSTRY
GREENHOUSE
NETWORK**



Australian Industry Greenhouse Network

Submission to Senate Select Committee on Climate Policy

TABLE OF CONTENTS

| | |
|--|-----------|
| Executive Summary | 3 |
| 1 Introduction..... | 4 |
| 2 Global emissions reduction effort | 5 |
| 2.1 Budget period length | 5 |
| 2.2 Global emissions trading | 6 |
| 2.3 Australia's international contribution | 6 |
| 3 Emissions trading..... | 7 |
| 3.1 An Australian emissions trading scheme | 7 |
| 3.1.1 Treatment of trade exposed industry in the absence of a global agreement | 8 |
| 3.1.2 Impact of a carbon constraint..... | 9 |
| 3.1.3 Treasury modelling | 10 |
| 4 Carbon Pollution Reduction Scheme | 10 |
| 4.1 Industry support..... | 11 |
| 4.1.1 Shifting the burden | 11 |
| 4.1.2 Voluntary action | 12 |
| 4.2 Other concerns | 12 |
| 5 The CPRS Bills..... | 13 |
| 5.1 Specific issues with the Bills | 15 |
| 5.1.1 CPRS Bill | 15 |
| 5.1.2 Consequential Amendments Bill | 16 |
| 5.1.3 Bills omissions | 17 |

| | | |
|----------|---|-----------|
| 6 | Complementary measures | 17 |
| 6.1 | Principles for complementarity | 18 |
| 6.2 | Measures additional to national emissions trading | 19 |
| 6.2.1 | Market failures with emissions trading..... | 19 |
| 6.2.2 | Emission sources and sectors not covered by emissions trading | 19 |
| 6.2.3 | Measures in transition | 20 |
| 7 | Conclusion..... | 20 |

EXECUTIVE SUMMARY

AIGN endorses the CPRS White Paper test for setting Australia’s emission budget at a level that is commensurate with “advanced economies taking on reductions comparable to Australia”. However, the -5% and the -15% ‘targets’ – representing a 25% to 35% reduction in emissions relative to expected trends and a 34% to 41% reduction from 1990 per capita emission levels – are 3 to 4 times stronger than other wealthier countries including the EU and the USA.

AIGN advocates that Australian’s shoulder a fair share of the global burden, no more and no less.

AIGN advocates that an efficient response to the challenge of reducing human induced greenhouse gas emissions must involve pricing emissions (and offsets) in a coherent way. A carefully designed emissions trading scheme has the potential to meet these requirements more economically efficiently and equitably than other pricing instruments such as taxes, grants and other financial incentives, although such instruments may have a limited role as part of an overall policy response.

However, the design of the Carbon Pollution Reduction Scheme (CPRS) fails to be environmentally effective and economically efficient in circumstances where there is no comprehensive and coordinated global agreement.

In AIGN’s view, in the context of a limited global agreement, the CPRS legislation will need to be amended to:

- Adopt a national permit budget to 2020 that is fair compared to the obligations of other advanced countries. As an example, this would translate into an Australian percentage emissions reduction ‘target’ that is about one-fifth that of the EU
- Cover 100% of emissions from the beginning so that arbitrary allocation of the national budget between the CPRS and the rest of the economy can be avoided
- Enable a sensible start to the scheme through a ‘safety valve’ price to 2020, which allows for a moderate rise in consumer prices and business costs, and fully compensates low income households
- Extend the upper and lower ‘gateways’ from 10 years to 15 years
- Fully offset the loss of trade competitiveness of industry for a transitional period

- determine all exports to be trade exposed
- determine import competing products whose prices move in tandem with import parity as trade exposed, and the trade exposure of other import competing products to be assessed by the Productivity Commission
- trade exposed operations should receive up to 100% of scope 1 permits and up to 100% of permits needed to fully offset costs passed-through by non-trade exposed industry (typically in electricity, gas and feedstock prices)
- remove allocation ‘decay’ of 1.3% per annum
- remove the artificial definitions of ‘activity’ that will mean that almost all trade exposed facilities will receive effective rates of allocation significantly below 90% and 60%
- remove permit allocation to trade exposed industries as dictated by international circumstances on a case-by-case basis
- if the scheme cannot be designed to offset competitiveness loss of import and export industry, then consideration may need to be given to other scheme designs such as the consumption-based approach proposed by Geoff Carmody
- Increase the assistance to the electricity generators that will suffer significant asset value loss to \$10 billion over 10 years
- Provide for the abolition or phasing out of existing schemes, including MRET and EEO
- Set out a comprehensive, publicly funded program for RD&D into frontier emission reduction technologies.

The objective of developing a coherent and streamlined set of climate change measures across jurisdictions has long been requested by industry – there are over 140 Commonwealth and State (and Territory) measures. Industry is yet to see any measure abolished and continues to witness the announcement of additional measures across jurisdictions. Until this situation is rectified, any claims that the CPRS can be economically efficient will be hollow.

1 INTRODUCTION

The Australian Industry Greenhouse Network (AIGN) welcomes the opportunity to respond to the terms of reference established by the Senate Select Committee on Climate Policy.

AIGN is a network of Australian industry associations and businesses that have a serious interest in climate change issues and policies. A list of AIGN member associations and corporations is at Attachment A.¹

All of AIGN's corporate members measure and report their emissions of the key greenhouse gases (GHG) in Australia and overseas, and are taking action to curtail them. AIGN's association members also regularly report on emissions by their members and on abatement actions being taken.

Many, being multinational industries and corporations, are directly involved in the international response to climate change, including emissions trading in Europe, or in various offsets programs around the world (and most have exposure to the various Federal and State emissions abatement schemes already imposed in Australia).

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

AIGN policy principles

AIGN has been an active participant in international and domestic deliberations on climate change policies since the early 1990s. Drawing on that experience, AIGN established in 2002 a set of climate change policy principles, which it uses to assess the merits of policy proposals.

These principles, set out in Box 1, have been accepted by all AIGN members and have stood the test of time.

¹ Origin Energy Ltd have chosen to absent themselves from this submission

Box 1: AIGN Climate Change Policy Principles

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

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

Australia should engage the international community to pursue global action to reduce greenhouse gas emissions leading to identified and beneficial environmental outcomes which:

- allow for differentiated national approaches;
- promote international cooperation;
- minimise the costs and distribute the burden equitably across the international community;
- are comprehensive in its coverage of countries, greenhouse gases, sources and sinks;
- recognise the economic and social circumstances and aspirations of all societies; and
- are underpinned by streamlined, efficient and effective administrative reporting and compliance arrangements.

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

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

Australia's future greenhouse policy measures should:

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

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

This sensitivity is now particularly pronounced as the extent to which the global economic downturn will permeate the Australian, and international, economy becomes more evident. Developing environmentally effective and economically efficient strategies to manage greenhouse gas emissions in a way that accounts for times of both economic prosperity and decline is a key challenge that policymakers have so far failed in the design of the Carbon Pollution Reduction Scheme (CPRS).

2 GLOBAL EMISSIONS REDUCTION EFFORT²

Australia, as a party to the United Nations Framework Convention on Climate Change (UNFCCC) and signatory to the Kyoto Protocol, ratified the Protocol on 12 December 2007, with the Protocol entering into force for Australia on 11 March 2008. Australia has committed to an assigned amount of +8% of 1990 emissions, which is achievable according to government sources.³

The Kyoto Protocol (the Protocol) aims to enforce international action to reduce greenhouse gas emissions by establishing greenhouse gas emission assigned amounts based on 1990 emissions levels for countries listed in Annex B of the Protocol for the commitment period 2008-2012. It binds Parties to the Protocol to implement emissions reduction policies “in accordance with its national circumstances”.⁴

Australia’s ratification of the Protocol, whilst significant, has now been superseded by the global effort to negotiate the next phase of international commitments. A critical principle of the UNFCCC is the concept of “common but differentiated responsibilities and respective capabilities”⁵. Despite more promising international dialogue, even with some agreement about the size of the global emissions abatement task that needs to be addressed, agreement on how that task is equitably shared among nations, including developing countries, will be difficult to achieve.

² Senate Select Committee on Climate Policy, Terms of Reference, 1(d) an appropriate mechanism for determining what a fair and equitable contribution to the global emission reduction effort would be;

³ Chapter 5 Australia’s Fourth National Report to the UNFCCC

⁴ Kyoto Protocol, Article 2.1.a

⁵ United Nations Framework Convention On Climate Change, 1992, http://unfccc.int/essential_background/convention/background/items/2853.php

In AIGN’s view, a global scheme to regulate greenhouse gas emissions is unlikely to be attainable if promoters persist with a Kyoto Protocol paradigm involving centralised rulemaking, monitoring and enforcement, with inadequate flexibility to accommodate differing national circumstances and continual (and often surprising) change. It would seem likely that important nations such as China and the USA would not be able to commit to a global agreement of this kind.

In considering how obligations might be equitably shared, the current dialogue continues to use the language of ‘developed’ versus ‘developing’ countries. In AIGN’s view, this is unhelpful. This categorisation fails to distinguish the economic progress of some countries, which are currently identified as developing, relative to some countries listed under Annex I to the Convention. For this reason, and despite the principle of “common, but differentiated responsibilities”, there has been limited progress on assigning any responsibility to many countries that are currently defined as ‘developing’ but are as at least as, or will soon be as, wealthy as many ‘developed’ countries.

AIGN commends the discussion of individual country obligations contained within the Australian submission to the UNFCCC, *Initial views on a long-term global goal for emission reductions*⁶, which advocates a process for establishing a new grouping of countries that are ‘advanced’ and those that are ‘less developed’, and how the latter might graduate to ‘advanced’ status over time. The former should be ready to take on commitments from 2012. The Australian submission identifies this alternative approach to differentiating countries on a basis of GDP per capita, and suggests that all UNFCCC Parties, particularly the top 15 emitters, will need to contribute towards collective mitigation efforts if the UNFCCC’s goals are to be met.

2.1 Budget period length

One of the significant elements of the Kyoto Protocol has been that the agreement is for a 5-year budget period. Such a short period is unhelpful for business.

It is generally agreed that the key to achieving significant reductions in global emissions will be in uncovering and

⁶ <http://www.greenhouse.gov.au/international/pubs/sharedvision-submission.pdf>

deploying new low emission technology. Equally, while governments have a significant role to play, it is accepted that both R&D and market deployment of these technologies will be driven by industry.

The Protocol's problem then is that, while 5 year budget periods will induce low-hanging-fruit emission abatement, it falls far short of the 'bankable' horizons for significant investments. Typically, for a major investment, a 15 to 20 year 'bankable' period is required.

The lesson then is that the international agreements must strive for longer budget periods. It is probably the case that the next agreed budget period for advanced countries would extend from 2013 to 2020. However, for robust business investment decisions which allow more efficient management of uncertainty, a budget period to 2030 would be much more effective – although, if that agreement was open to significant renegotiation, any gains in investment confidence may be undone.

2.2 Global emissions trading

An international framework that progresses the national commitments under the UNFCCC will be critical in meeting any ambition to implement an international emissions trading scheme. Until this happens it would seem improbable that an international emissions trading scheme that encompasses the majority of emissions in the majority of countries will emerge soon.

On the other hand, the EU will continue its scheme beyond 2012 and it is possible that individual countries, or groups of like-minded countries, could implement emissions trading schemes. While this is not the only possible outcome, the result will most likely be a 'constellation' or 'patchwork' of different national and regional schemes, with hopefully an open-door policy for new countries and regions to 'opt-in'.

If this assessment is realistic, the chance of a single, global emission price emerging anytime in the next investment cycle is very remote. It is not unlike the probability of all global trade barriers being removed in the next 20 years, that is, AIGN expects any global scheme to have competitiveness distortions.

This assessment should by no means be taken to be a pessimistic view. Rather it is reached with full recognition of the need to accommodate the genuine aspirations of all

nations, not least those of developing countries, to meet their social and economic objectives; and the cause for optimism is that many countries are likely to adopt their own 'targets' in the absence of an international agreement.

2.3 Australia's international contribution

Current Australian domestic policy developments cannot be considered in isolation from the international negotiations that are progressing under the UNFCCC. The position that the Australian Government takes in negotiating its future international commitments has critical implications for the design of a domestic emissions trading scheme, and the determination of the emissions 'cap' in that scheme.

However, in AIGN's view, the Australian Government must be cautious in adopting an overly ambitious domestic 'trajectory' or 'budget' for its emissions trading scheme in advance of a better understanding of the position of other 'advanced' countries. Remembering that Australia's share of global greenhouse gas emissions is less than 1.5%⁷, there is, generally speaking, little or no global environmental benefit (in respect of global greenhouse emissions) in Australia imposing a harsher carbon constraint relative to other 'advanced' countries' commitments.

AIGN endorses the CPRS White Paper test for setting Australia's emission budget at a level that is commensurate with "advanced economies taking on reductions comparable to Australia". However, both the -5% and the -15% targets – representing a 25% to 35% reduction in emissions relative to expected trends and a 34% to 41% reduction from 1990 per capita emission levels – are stronger than other wealthier countries including the EU, the USA and the UK.

As set out in Table 1, Treasury modelling estimates that these targets mean that Australians could incur wealth losses, as measured by loss in GNP, about 3 times higher than the Americans (compare Australia -4% in CPRS-5 with USA -6% of 1990 in CPRS-15) and substantially more than 4 times higher than the losses that Europeans

⁷ World Resources Institute, *Navigating the Numbers: Greenhouse Gas Data and International Climate Policy*, Chapter 2, 2005, http://archive.wri.org/publication_detail.cfm?pubid=4093

(compare Australia -14% in CPRS-15 with EU -34% of 1990 in CPRS-15) bear in 2020.

Table 1: Targets and costs in 2020

| | Target (% 1990 emissions) | | Cost |
|----------------|---------------------------|------------------|-------------------|
| | Change from Kyoto target | Change from 1990 | Change in GNP (%) |
| CPRS-5 | | | |
| Australia | -12 | -4 | -1.1 |
| Canada | +17 | +11 | -1.1 |
| Japan | -15 | -21 | -0.2 |
| USA | n.a | +5 | -0.3 |
| EU | -27 | -34 | -0.4 |
| Russia | -25 | -25 | -3.6 |
| World | | | -0.7 |
| CPRS-15 | | | |
| Australia | -22 | -14 | -1.6 |
| Canada | +5 | -1 | -1.5 |
| Japan | -23 | -29 | -0.4 |
| USA | n.a | -6 | -0.4 |
| EU | -34 | -41 | -0.6 |
| Russia | -33 | -33 | -5.3 |
| World | | | -0.9 |

Source: Australian, Economic cost as an indicator for comparable effort, Submission to the AWG-KP and AWG-LCA, March 2009

AIGN advocates that Australian's shoulder a fair share of the global burden, no more and no less.

3 EMISSIONS TRADING⁸

AIGN recognises that an efficient response to the challenge of reducing human induced emissions of greenhouse gases to the atmosphere (and sequestering carbon from the atmosphere) must involve pricing emissions (and offsets) in a coherent way. AIGN is disposed to utilising the discovery power of markets to ensure that costs are minimised and predictable, and investments are rationally allocated.

Over the longer-term, a carefully designed emissions trading scheme has the potential to meet these requirements more economically efficiently and equitably than other pricing instruments such as taxes, grants and other financial incentives, although such instruments may have a role as part of an overall policy response.

⁸ Senate Select Committee on Climate Policy, Terms of Reference, 1(a) the choice of emissions trading as the central policy to reduce Australia's carbon pollution, taking into account the need to: (i) reduce carbon pollution at the lowest economic cost, (ii) put in place long-term incentives for investment in clean energy and low-emission technology, and (iii) contribute to a global solution to climate change;

With respect to an emissions tax, it is often claimed that it too could also have the efficiency benefits of a trading scheme. Indeed, many economists prefer a tax to a tradable permit scheme on efficiency grounds. Carefully designed, a broadly based tax could be integrated into existing tax systems making them administratively simple, relatively speaking, and would provide near-term price certainty.

However, the asserted price certainty of a tax is likely to be illusory, given that rates could be expected to change through time as governments re-assess mitigation imperatives. Of course, quantitative emissions or price targets (caps) could also be expected to change over time in an emissions trading scheme however, unlike a tax, a trading scheme can incorporate design features that allow markets to assist in that longer-term price discovery and, importantly, provide financial instruments to help manage the inevitable emissions price uncertainty.

Further, an emissions trading scheme provides a great deal of flexibility in the way in which equity issues might be dealt with. For example, permit allocations can be used to compensate businesses for asset value losses, and this compensation need not be re-visited as the price of permits changes over time.

However, in both the global and domestic contexts, emissions trading alone is unlikely to be a sufficient policy response to tackle the array of technology circumstances and challenges. These are further explored in AIGN's comments below on complementary measures.

3.1 An Australian emissions trading scheme

The reality of an imperfect global response to greenhouse emissions abatement dictates that a key issue for policymakers is whether a national emissions trading scheme can be designed to preserve for a transitional period the major competitive advantages Australia enjoys through the possession of large reserves of fossil fuels and uranium.

The principal conundrum for Australia is the fact that overseas competitors for many of the resources, resource processing and other energy intensive industries, which have been the drivers of Australian prosperity and growth for over three decades, are located predominantly in

countries that will not impose an equivalent greenhouse gas emissions penalty in the foreseeable future. Key competitors are in the Middle East, in Asia, in South America and in southern Africa. To impose any significant penalty on Australian industries, whether import competing or exporting, when competitors remain exempt would encourage the diversion of investment to offshore jurisdictions for no environmental benefit.

The requirement to preserve competitiveness is therefore potentially long-lived, and must address both existing operations and new investment.

The rationale for shielding trade exposed industries until such time as overseas competitors implement comparable schemes is well known to the Government, and was plainly expressed in election policy documents⁹. Specifically, the Australian Labor Party pledged that an ALP Government would establish “specific mechanisms to ensure that Australian operations of emissions intensive trade exposed firms are not disadvantaged by emissions trading.”

Treasury modelling has supported the concerns expressed by the Government, and the Opposition when it was in government. One of the key findings of the modelling is that developing countries that delay taking on emission reduction commitments experience a surge of investment in energy and minerals processing industry¹⁰. This surge in investment is ‘carbon leakage’ from countries like Australia that take on early ‘targets’.

In this context, the AIGN has argued that a well-designed emissions trading scheme, which balances economic efficiency, environmental effectiveness and equitable burden sharing, will provide a framework for least-cost abatement of greenhouse gases.

AIGN supports an emissions trading scheme that:

- Balances economic, environment and equity objectives
- Is comprehensive of gases, sectors and sinks
- Offsets the competitive loss of emission intensive trade exposed industry, in the context of a limited global agreement, and assists the structural adjustment of severely affected industry

- Replaces the raft of Federal and State programs that impose costs on business, and stops new measures being imposed
- Is environmentally effective, including by inducing more nations to commit to emission reductions
- Is fair so that no one shoulders a disproportionate burden of the cost of mitigation.

3.1.1 Treatment of trade exposed industry in the absence of a global agreement

In setting an Australian trajectory or budget, and negotiating a new international commitment, Australia must fully consider the circumstances of its economy relative to other advanced countries – particularly Australia’s emission trends, GDP growth, population growth, energy sources and Australia’s resource endowment, upon which much of our economic prosperity is based. In the absence of an agreement among advanced countries, this means building into Australia’s emission budget room for new emission intensive trade exposed projects in Australia.

AIGN believes agreement will be difficult to reach and drawn out over many years. In these circumstances, other approaches need to be explored in parallel with negotiation of a comprehensive global agreement. One such approach derives from Professor McKibbin’s work, and is endorsed in Professor Garnaut’s draft report¹¹.

The proposition is that the countries that are competing for new investment in globally traded emission intensive goods (GTEIG) would agree to equally tax those new projects. In this way, investment decisions in those new projects would not be distorted by the absence of a comprehensive global emission reduction agreement. Further, once a GTEIG agreement is struck between countries, there would be no need to retain an offset for competitive loss in the Australian emissions trading scheme.

Another approach would be for the same countries that are competing for new investment in GTEIG to negotiate their emission reduction budgets such that they exclude new GTEIGs. This concept is known as the ‘above the cap’ approach. Again it is only necessary until such time as a comprehensive global agreement is put in place.

⁹ *Labor’s Plan for a Stronger Resources Sector*, Senator Chris Evans, Shadow Minister for National Development, Resources and Energy, ELECTION 2007

¹⁰ *Australia’s Low Pollution Future: the economics of climate change mitigation*, Box 5.2, page 104

¹¹ Garnaut Climate Change Review, *Draft Report*, June 2008

In yet another approach, Geoff Carmody¹² has recognized the problem and proposed a consumption-based scheme that, for the period of transition to a comprehensive global agreement (and beyond), would ensure trade neutrality for countries that take on emission reduction commitments earlier than others. China has also noted the potential for a consumption-based approach¹³.

In essence, the scheme ensures that:

- All exports are rebated emission costs, both direct costs and emission costs embodied in inputs. An importing country would be free to impose an emissions charge at the same rate as it imposes on a domestic equivalent
- All imports are assigned an emissions cost at the same ad valorem rate as the equivalent domestic product. That is, at least initially, imports are assumed to have the same emission intensity as domestic production.

The key to the proposal is that it is trade neutral in exactly the same way as is GST and it can piggy-back on our existing GST systems for implementation.

An advantage of the Carmody approach is that it avoids the large transfers in revenues from countries taking on relatively tough targets to other nations. This is not an issue about the merits of such transfers, but rather relates to the issue of how a truly global agreement can possibly be struck. Nations that are the potential beneficiaries are being given an incentive to remain so, and nations providing the funds face the politically difficult task of convincing voters at home to agree to lower their living standards – it is this very feature of the Kyoto Protocol that will ensure that the American Congress and other key nations such as China will not ratify any global agreement of the Kyoto Protocol type.

AIGN believes that more work needs to be done to identify and analyse potential international approaches that might progress the negotiations.

3.1.2 Impact of a carbon constraint

The impact of a carbon constraint for Australia that is disproportionate to other advanced countries should not be underestimated. The implications for Australia will depend on how comprehensive the coverage of the global constraint is, and how quickly the constraint is imposed

relative to the cost of technologies that are available to meet the task.

If the constraint is globally comprehensive, AIGN would expect the Australian economy to be more exposed to larger negative economic impacts relative to most other advanced nations. This is because the structure of the Australian economy is more emissions intensive, and its trade exposure is more emissions intensive, than other advanced countries likely to take on similar emissions reduction commitments. If the constraint is confined to a few countries, the economic implications for the Australian economy could be severe depending on the level of emissions reduction and whether Australia could successfully offset the trade exposed industry loss of competitiveness until a global framework is implemented.

The economic implications for Australia, and for other nations for that matter, are also more severe the more the task is misaligned to the availability of lowest cost technology. There is little point in imposing a high cost on the economy if the technologies to achieve radical emission reductions at least-cost are not available.

In the expectation that the current international negotiations are not able to draw emission reduction commitments from most countries with which Australia competes, the impact of such an emission constraint on the competitiveness of Australian industry needs to be properly considered. Trade exposed industries include the export oriented industries encompassing energy, mining and minerals processing, and import competing industries across general manufacturing including chemicals and plastics, cement, lime, pulp, paper, glass, sugar, food processing and petroleum refining (many of whom have already reduced their emissions significantly and have few remaining low cost options). They also include some trade exposed agricultural industries with high emission intensities such as livestock and some cropping.

The energy intensive industries, and their importance in the Australian economy (both directly and in providing the essential energy services that support the rest of the economy), have built their presence on the back of Australia's resource endowments and, in particular, the nation's advantage as a producer of low cost energy. These Australian advantages in world trade will be dissipated if carbon emissions are significantly penalised in the absence of a global constraint, and Australia's

¹² Geoff Carmody, On Line Opinion,

<http://www.onlineopinion.com.au/author.asp?id=5613>

¹³ <http://www.spiegel.de/international/world/0,1518,611818,00.html>

economic growth will be weaker with diminished investment in these industries.

Lower investment in these industries in Australia, however, is unlikely to dampen investment in those industries worldwide. All of them have a history of building new facilities in the most competitive locations — and for these industries, emissions costs, if comparable to energy costs, would be a key competitiveness driver. An important characteristic for Australia, in respect of many of these industries, is that our competitors almost without exception include countries in the developing world where the prospect of emissions penalties being imposed is distant, unless a new paradigm around ‘advanced’ countries can be negotiated. Locating these industries in the Middle East, Asia or elsewhere, rather than in Australia, at Australia’s cost in terms of reduced economic development and income, would be of little avail in the goal of reducing global emissions.

This is the ‘carbon leakage’ problem, often downplayed in developed country circles, which is a very real issue for Australia, given our unusual export profile relative to other developed countries. These realities are not unfamiliar to policy makers, and industry would be obliged to interpret any decision by government to impose cost penalties like an emissions trading scheme, in the absence of a global framework, and without appropriate transitional offsetting measures, as a judgement that the environmental benefits, including the agreed need for developed countries to ‘take the lead’ in this matter, are of greater value than the adverse consequences for growth, employment and regional development.

3.1.3 Treasury modelling

It is claimed in the White Paper that Treasury modelling¹⁴ demonstrates that the impact of the CPRS on the Australian economy is mild and that ‘carbon leakage’ is overestimated. Both assertions are themselves overplayed.

In regard to the claims that the Treasury modelling indicates that the CPRS has a mild impact on the economy, the following issues are important:

- The Treasury report cautions readers about the shortcomings of the modelling. In particular, the report states that “The models do not capture well the short-term economic adjustment costs; instead, they explore long-term multi-sector impacts...The CGE models, therefore, provide a more robust analysis of the post-transition economy than of the transitional process.”¹⁵ This caution is very significant and affirms that the modelling substantially underestimates the impacts on the economy to 2020
- The models describe the ‘perfectly optimal’ outcome with capital and labour immediately and at no cost shifting to the next best economic activity
- The permit price scenarios assumed in the modelling significantly underestimate the real world permit prices, and hence the economic impact
- The modelling does not report the impacts on employment, but rather prefers to report significant impacts on real wages
- There are numerous other assumptions in the modelling that tend to suppress the economic impacts.

Concerning ‘carbon leakage’, as already observed, one of the key findings of the Treasury modelling is that developing countries that delay taking on emission reduction commitments experience a surge of investment in energy and minerals processing industry. This surge in investment is ‘carbon leakage’ from countries like Australia that take on early ‘targets’.

4 CARBON POLLUTION REDUCTION SCHEME¹⁶

Overall, the Australian Government’s CPRS White Paper is an improvement on the Green Paper, but offers considerable scope for further changes to deliver better economic and environmental outcomes that are fairer to all Australians. AIGN’s concern is that the CPRS has been conceived in ‘the good times’, but is not robust for times of economic downturn, whether now or in the future.

¹⁵ Op cit Section 2.3.3 page 22

¹⁶ Senate Select Committee on Climate Policy, Terms of Reference, 1 (c) whether the Government’s Carbon Pollution Reduction Scheme is environmentally effective, in particular with regard to the adequacy or otherwise of the Government’s 2020 and 2050 greenhouse gas emission reduction targets in avoiding dangerous climate change; & 1(e) whether the design of the proposed scheme will send appropriate investment signals for green collar jobs, research and development, and the manufacturing and service industries, taking into account permit allocation, leakage, compensation mechanisms and additionality issues;

¹⁴ *Australia’s Low Pollution Future, The Economics of Climate Change Mitigation*, October 2008

4.1 Industry support

The CPRS proposes a program of permit allocations to emission intensive trade-exposed industry and Climate Change Action Fund (CCAF) grants for other industry. The proposed program, however, does not offset the competitive disadvantage of trade-exposed businesses, and losses of jobs and investment will be inevitable, for minimal environmental gain under the -5% unilateral target. Within the coverage of the proposed emissions trading scheme, and leaving aside agriculture, 45% of Australia's emissions are associated with potentially trade-exposed businesses. However, the CPRS asserts that just 25% of permits will be sufficient to ensure no loss of competitiveness, investment and jobs from these businesses.

A key mischief promoted in this debate is that transitional assistance to trade-exposed businesses is a gift of taxpayers' money to 'rent seekers'. The White Paper estimates that at a price of \$25/tCO₂ the emission permits in the trading scheme will be valued at about \$11.5 billion in 2010-11. This \$11.5 billion is not a magic pudding of taxpayers' money created (from nothing). Rather it derives from the increased costs of living for consumers and the lost profits of businesses. In particular, most trade-exposed businesses are unable to pass-on any emission costs and no trade-exposed business will be able to recover all emissions costs. The result of the CPRS is that in 2010 the Government may impose over \$5 billion in costs on existing trade-exposed businesses, but is proposing to provide just \$3 billion in relief declining at a rate of 1.3% per annum for existing businesses – this is nothing more than a productivity tax.

AIGN estimates, assuming a historical growth rate in trade-exposed industries of 1.5% per annum excluding agriculture, and complete removal of the subsidy for petrol in 2013, that there is between \$25 and \$30 billion worth of permits unallocated by 2020. Clearly there are sufficient permits to deliver a better outcome for all trade-exposed businesses without reducing the compensation to households proposed in the CPRS.

Importantly, the CPRS proposes to allocate permits to coal-fired electricity generators that will suffer considerable asset value loss under the emissions trading scheme. However, the level of compensation offered is just \$3.7 billion, whereas modelling published in the White

Paper shows losses around \$10 billion at a permit price of \$25/tCO₂. In addition, there maybe other non-trade exposed industries that could suffer significant asset value loss. A fairer outcome is needed.

4.1.1 Shifting the burden

The Government asserts that permit allocation to trade exposed industry increases the economic cost of the CPRS and shifts the burden of emission reduction costs to households and other sectors of the economy.

The Treasury modelling debunks two claims associated with these assertions¹⁷:

- Permit allocation to industry does not increase the economic burden of the rest of the economy because, contrary to the claims, it does not induce an increase in emission permit prices. Where permit prices in Australia are either controlled by international prices or by a sensible 'safety valve' price, the allocation of permits within Australia does not change the permit price in Australia
- Permit allocation to industry does not, as claimed, reduce the incentive for these industries to invest in emission reduction opportunities. The proposed permit allocation design, based as it is on benchmark emission intensities, preserves the power of permit prices to induce efficient investment in emission reductions.

Since the White Paper, the debate has now shifted – the claim now being made is that, having arbitrarily determined that trade exposed industry might receive about 25% of permits (about 110 million permits), any claim by industry for more permits must therefore reduce the number of permits auctioned, and hence the revenue available to compensate households. The validity of this claim rests solely on the assertion that about 110 million of permits was in the first place the "right" amount to allocate to trade exposed industry.

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

¹⁷ *Australia's Low Pollution Future, The Economics of Climate Change Mitigation*, October 2008

Rightfully allocating permits to trade exposed businesses does not shift the burden to the rest of the community. On the contrary, arbitrarily restricting allocation shifts the burden to trade exposed businesses, and subsidizes households.

It is possible to identify where some of the permits that should be dedicated to TEIs have been misdirected.

First, the Government has decided to over-compensate households for the costs they might incur. As the White Paper points out, low and middle-income households are compensated by an average 120% of the modelled increase in the CPI – this equates to about an extra 40 million permits auctioned every year.

Second, at least until 2013, households will be fully compensated for any increase in petrol prices – this equates to about 80 million permits auctioned every year. After 2013, motorists will inexplicably continue to be partially compensated.

It seems up to 120 million permits per annum have been assigned to raise revenue to over-compensate households. Yet a maximum of a further 90 million permits is required to fully deliver the temporary offset of TEI competitive disadvantage.

4.1.2 Voluntary action

Another fiction gaining public traction is that voluntary action on the part of individuals will allow 'big polluters' to pollute more, or sell their excess permits to other 'polluters', negating the benefit of private action. The claim is based on a number of false premises.

First is the premise that industry is the 'polluter' and hence only they are responsible for saving emissions under the CPRS.

It is important to remember that, on a production basis, only about 45% of emissions covered by the CPRS are attributable to mining and manufacturing industry. The rest are attributable to households, and the commercial and government sectors (where households shop, work, go to school etc). On a consumption basis, excluding exports, all Australian emissions are attributable to households as consumers - if we stop producing cement or even cans of soup in Australia because of the CPRS, Australian consumers will still buy (import) cement and cans of soup. It is crucial that industry, households, commerce and governments respond to the emissions price signal and reduce their emissions.

Second is the premise that the CPRS mandates emission saving by 'polluting' industry and hence savings by households are voluntary. Nothing in the CPRS mandates emission savings by anyone. Under the CPRS, the number of emission permits a company has to purchase to meet its liabilities is directly related to its own emissions and unrelated to household emissions. The financial incentive for households and companies alike to 'voluntarily' save emissions, and in the case of companies to therefore avoid the need to purchase permits, will be that a price is put on those emissions.

Third is a misunderstanding created by the use of the words 'target' or 'cap' to describe the number of permits that will be allocated under the CPRS. To meet the very difficult 'targets' the Government has nominated for Australia will mean that permits will have to be purchased and imported from overseas if a least-cost outcome is to be achieved. As a consequence, any emission savings voluntarily made by households and industry will reduce the number of permits imported. This will not reduce the price of permits in Australia, and therefore subsidise anyone, because under the CPRS that price will be set by world markets.

Finally, if the claim were true, then equally it would be true to say that every tonne of emissions saved by industry will subsidise higher emissions by households. Clearly the claim is a nonsense.

4.2 Other concerns

AIGN has other key areas of concern associated with the CPRS:

- The CPRS leaves the level of economic impact on the Australian economy to be determined by the global price of emissions as driven by the Clean Development Mechanism (CDM). This would be acceptable if the CDM was efficient and Australia negotiated an appropriate emission budget to compensate for the expected impacts on the economy. However, neither of these conditions is evident in the White Paper. AIGN notes that the Treasury modelling report does not model any scenarios for CDM permit prices and, hence, possible Australian permit price scenarios. The only effective means of limiting the economic impact of the emissions trading scheme is to adopt a 'safety valve' price cap. AIGN also notes that the Treasury

modelling report does not model the economic implications of a \$40/tCO₂ ‘safety valve’ price (rising at 7.5% real per annum) as proposed by the CPRS

- It is not yet clear how the Government will use its R&D funds to assist the large scale demonstration of new technologies before they become commercially viable under the emissions trading scheme. AIGN supports funding of innovative elements of these projects on ‘public good’ grounds
- The Government has proposed the 60,000GWh Renewable Energy Target (RET) scheme notwithstanding that it is displaced on policy grounds by the emissions trading scheme. As already argued, the RET does not meet the COAG principles for climate change mitigation measures that are complementary to the CPRS. Every independent review undertaken, including by Professor Garnaut, the Productivity Commission and the Treasury, has recommended that the current MRET scheme should not be expanded and should be phased out. AIGN also notes that the policy was to produce 20% of electricity from renewable sources by 2020, and that with the CPRS scheme and the resulting reduction in electricity demand, the result of the 45,000GWh target in the draft legislation released by the Government late last year will be a much tougher and more costly target of almost 25%
- It is likely that the Federal Government decisions to retain and adopt new measures that do not meet COAG principles, as represented by the RET, will be influential on State and Territory governments. The proliferation of overlapping and costly policies will continue, removing any claims to economic efficiency that might remain for the CPRS.

5 THE CPRS BILLS¹⁸

AIGN has devoted much of the last few years to the various stages undertaken across jurisdictions to develop an Australian emissions trading scheme, which has now been presented as the CPRS.

It is generally agreed that the introduction of the CPRS will represent one of the most significant reforms to the economy ever attempted. Considerable effort has been expended to explore the design elements of an emissions trading scheme, and it would be disappointing that any unwarranted haste to implement this scheme would undermine years of sincere work on behalf of the community and Government.

In its submission to the Senate Economic Committee into the CPRS Bills, AIGN contested that the economic implications of the CPRS cannot be assessed at this time for two key reasons.

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

- The economic implications for Australia are closely tied to the economy-wide emission commitments Australia adopts relative to the commitments adopted by other countries. At this time, only a handful of advanced countries, where ‘advanced’ is defined as all countries with GDP per head at least as high as the Ukraine in line with Australia’s submissions to the UNFCCC, have indicated their possible commitments. Most advanced countries are unlikely to identify their possible commitments before the UNFCCC negotiating session in Copenhagen in December 2009
- A significant determinant of the level of impact on the economy will be the elements of the CPRS legislation designed to offset the loss of trade competitiveness of export and import competing industry during a period of transition to a coordinated and comprehensive global commitment to reduce emissions. The draft Bills devote just six pages to this vital element of design and provide no detail of substance. AIGN understands that

¹⁸ Senate Select Committee on Climate Policy, Terms of Reference, 1 (c) whether the Government’s Carbon Pollution Reduction Scheme is environmentally effective, in particular with regard to the adequacy or otherwise of the Government’s 2020 and 2050 greenhouse gas emission reduction targets in avoiding dangerous climate change; & 1(e) whether the design of the proposed scheme will send appropriate investment signals for green collar jobs, research and development, and the manufacturing and service industries, taking into account permit allocation, leakage, compensation mechanisms and additionality issues;

all of the details that will determine the impacts on trade-exposed industry will be contained in regulations and the final set of these regulations will not be brought before Parliament until the first quarter of 2010, just three months before the scheme is scheduled to commence

- Other significant elements of the legislation yet to be drafted include the auctioning scheme and the amendments to the Excise Tariff Act affecting transport fuel prices
- Although the elements of the CPRS impacting on the electricity generation sector are more detailed in the draft Bills, because important elements will be set in regulations, the full impacts will also not be known until early in 2010
- The CPRS Bills will be just one element of a balanced response to reduce emissions. In particular, to reap the economic efficiency rewards of an emissions trading scheme a strong publicly funded program of RD&D is required and, importantly, the plethora of Commonwealth and State schemes that impose additional costs on industry need to be removed. There is nothing in these draft Bills that address these issues and therefore a robust economic assessment is not yet possible
- AIGN notes that the modelling so far released by the Treasury provides very little insight into the likely economic impacts on Australia. None of the scenarios modelled by Treasury address one of the most likely outcomes from the Copenhagen negotiations, that being the Government's commitment to a minimum - 5% below 2000 emission permit budget by 2020 with a fragmented international agreement.

Second, the scope and longevity of deteriorating global economic conditions raises considerable uncertainty about the capability of industry and households to fund emission saving investments to respond to the price signal being created by the CPRS. For as long as these circumstances continue to prevail, industry and households will in effect be confronted with a tax that they cannot avoid, thereby limiting the emission reductions that can be effected. This will be a poor environmental outcome.

In AIGN's view, if flaws in the CPRS are to be avoided, and in the context of a limited global agreement, then the CPRS legislation will need to:

- Adopt a national permit budget to 2020 that is fair compared to the obligations of other countries. To

illustrate, the current EU ETS at a permit price of €10/tCO₂ (about A\$20/t) adds about 8% to the EU wholesale electricity price. Since permit price is a good proxy for economic impact, then an equitable equivalent Australian permit price should also add 8% to Australian wholesale electricity prices – currently, that would translate into about \$4/tCO₂

- Cover 100% of emissions from the beginning so that arbitrary allocation of the national budget between the ETS and the rest of the economy can be avoided
- Enable a sensible start to the scheme, which
 - allows for a moderate rise in consumer prices and business costs to avoid a sharp shock to the economy to 2020
 - fully compensates low income households
 - offsets the competitive loss of trade exposed industries and compensates strongly affected industries
- Allocate the full budget of permits, with the actual trajectory of emissions within the budget period to be determined by the market
- Set upper and lower 'gateways' for 15 years, and reviews, and rolls forward, the firm budget and gateways every 5 years, by 5 years. The proposals in the CPRS, to give 10 to 15 year budgets and gateways, are too short to support management of risk in 'bankable' investment, including investment in RD&D
- Set a sensible 'safety valve' price trajectory to 2020 that caps the economic impact that the community is prepared to accept. This price trajectory could be abolished when the community had confidence in the maturity and stability of the domestic and international emissions markets
- Establish a transparent and robust process for setting Australian emission budgets to 2050 that is reflective of, and assists progress in international negotiations, including the pursuit of an international agreement based on at least a 10 year forward basis, not the shorter periods contemplated for the Kyoto Protocol
- Fully offset the loss of trade competitiveness of industry. AIGN estimates that non-agriculture industry accounts for over 200 million tonnes of emissions, whereas the White Paper estimates an allocation of perhaps 110 million tonnes. Amendments to the trade exposed industry program in the CPRS would include
 - determine all exports to be trade exposed
 - determine import competing products whose prices move in tandem with import parity as trade

exposed, and the trade exposure of other import competing products to be assessed by the Productivity Commission

- remove the zero, 60% and 90% rates – to be fully effective, trade exposed operations should receive up to 100% of scope 1 permits and up to 100% of permits needed to fully offset costs passed-through by non-trade exposed industry (typically in electricity prices, gas prices and feedstock prices)
- remove allocation ‘decay’ of 1.3% per annum-allocate to existing operations based on fixed relationships between output and scope 1 and non-trade exposed cost pass-through measured in a typical recent year or average of years. Allocate to greenfield and brownfield projects based on international best practice at the time. Both these approaches will efficiently deliver the incentive for business to improve their emission productivity driven by the price of permits
- remove the artificial definitions of ‘activity’ that will mean that almost all trade exposed facilities will receive effective rates of allocation significantly below 90% and 60%
- if these design changes are made, then the complicated design elements involving ‘emission intensity’ tests and artificial definitions of ‘activity’ can be dispensed with
- if the scheme cannot be designed to offset competitiveness loss of import and export industry, then consideration may need to be given to other scheme designs such as the consumption-based approach proposed by Geoff Carmody
- Provide greater assistance to the electricity generators that will suffer significant asset value loss. The CPRS proposes assistance that is about one third that required
- Provide for the abolition or phasing out of existing schemes, and a means to prevent the adoption of new schemes, that impose additional costs on industry
- Set out a comprehensive, publicly funded program for RD&D into frontier emission reduction technologies.

5.1 Specific issues with the Bills

In the few weeks since the draft Bills have been released, AIGN members have been attempting to come to grips with what is, and what is not, included in the Bills, and

what the implications of the draft Bills in the current form will be.

This is further complicated by some notable omissions within the Bills – which has restricted the ability of industry to comment comprehensively on the scheme design. In the limited time available since the release of the legislation, AIGN has identified a number of issues. The issues discussed below are not exhaustive, and will invariably be added to, or resolved as clarifying discussions are conducted over the forthcoming months.

5.1.1 CPRS Bill

Objects (Part 1, Section 3)

The objects of the CPRS Bill are inadequate and should include to:

- a) impose a price on emissions
- b) offset competitive disadvantage for trade exposed industry
- c) offset asset value loss for strongly affected industry
- d) replace existing measures (MRET and EEO).

National Scheme Cap and gateways (Part 2, Section 14 and 15)

- Matters that the Minister ‘must’ take into account in setting the 5 year caps and 10 year gateways include the report (if any) of the Expert Review Committee (Section 14(5)(b) and 15)
- The expert Review Committee does not allow appointment of a person that is/has in the last 5 years worked for a liable party (section 360)
 - it would be far better for the Reviews to be done by the Productivity Commission with terms of reference determined by Parliament
- The matters that the Minister ‘may’ take into account in setting the 5 year caps and 10 year gateways is limited
 - there is no definitions of major or advanced economies
 - there is no definition of voluntary action, although Part 14, ‘voluntary cancellation’ provides a good option
 - there is no methodology for increasing the coverage of the CPRS

- The Minister ‘may’, but need not, set 10 year gateways. The Bill should require the Minister to set the gateways.

OTN (Part 3, Division 4, Sections 31&32 and 35-40)

An Obligation Transfer Number (OTN) is mandatory for LPG and natural gas sale to retailers, but for other fuels, except liquid petroleum fuels, mandatory use of an OTN is restricted to large users (ie 25,000t emissions)

- Currently, exporters will be required to ask their foreign customers to apply for an OTN if the transfer of ownership of the products takes place in Australia before export. This is an unnecessary administrative cost for customers of Australian exports
- The draft legislation does not enable the quotation of an OTN for all instances where the eligible upstream fuel is being supplied as a feedstock in circumstances a majority of the fuel is not combusted. This could result in the upstream liability being greater than the liability would have been if the recipient was accountable for its own emissions. Given the criticality of this issue to the plastics and chemicals sector, who sequester carbon in their products, a mechanism should be developed for the mandatory quotation of OTN's when used as a chemical feedstock.
- In all circumstances where the OTN is voluntary, the recipient has the discretion as to whether it quotes the OTN and the supplier may refuse to accept the OTN. Objective criteria for the refusal to use or accept an OTN should be developed in order to ensure that the use or otherwise of an OTN is not abused for commercial leverage.
- In circumstances where the upstream supplier is tasked with the responsibility of acquitting permits in relation to the downstream combustion of a fuel, consideration should be given to ensuring that the upstream supplier can pass through the costs of such acquittal to the emitter. There may be circumstances where, at least initially, the upstream supplier is unable to collect the permit liability from the recipient.

Auctioning (Part 4, Division 2, Subvision C)

- If auctioned permits and permits purchased at the ‘safety valve’ price are regarded as a tax, or not, then this may have different implications for existing contracts and their cost pass-through provisions
 - the general consensus is that they are not a tax.
- In respect of the proposed auctioning of permits, deferred payment arrangements should not impose

additional working capital burdens on scheme participants

- The auctioning design is open, with a discussion paper proposed for the end of March. This paper has not been released in early April.

EITE (Part 8)

- The EITE provisions are minimal and will have no administrative or legal review
 - note also that removal of EITE allocation is only covered in broad terms and AIGN is informed no regulations are proposed
 - Sections 165 (e) and (f) are unacceptable. What is required is that EITE allocation for an ‘activity’ should only be removed after a review by the Productivity Commission finds that international competitors in that ‘activity’ are subject to an equivalent emission impost.

Coal-fired electricity generation (Part 9)

The strongly affected industry provisions are almost complete, however issues to do with regulations on NPV and windfall profits are yet to be provided

- It is important that the objects of part 9 are amended to allow for the offsetting of asset value loss in the electricity sector
- Given the object of this section refers to the asset loss value in the electricity sector, the quantum of assistance should not be limited and instead capped at a maximum level as reflected in the ACIL Tasman and ROAM modeling commissioned by the Treasury
- Issuing 10-year forward dated permits should be considered
- The windfall gains test should be assessed against the ‘net revenue’ loss over the pre-CPRS expected life of the asset
- AIGN notes the reverse onus of proof on windfall gain.

5.1.2 Consequential Amendments Bill

National Greenhouse Gas and Energy Reporting Act

- A full review of NGER amendments is needed
- It is not clear why parties liable under the CPRS should be required to continue to meet NGER requirements particularly when there remain problems with contractors

- Significant revisions to NGERs emissions methodologies with 5 years notice is not covered in the Bills, whereas it is proposed in the White Paper.

Corporations Act

Trade in Australian (AEU) and international emissions units are 'financial products' for the purposes of Chapter 7 of the Corporations Act 2001. The accompanying commentary states that:

"These amendments will provide a strong regulatory regime to reduce the risk of market manipulation and misconduct. Appropriate adjustments to the regime to fit the characteristics of units and avoid unnecessary compliance costs will be made. Further consultation will be undertaken on the adjustments that will be necessary."

- If AEU's and eligible international emission units are categorised as 'financial products', many liable entities will need to obtain Australian Financial Services Licences in order to maximise their acquisition strategies. Obtaining a licence can be a significant process taking upwards of 6 months with major ongoing compliance issues
- A Consultation Paper was to be issued in March, but as yet has not
 - clearly the trading of derivatives needs to be licensed
 - however, there seems little logic to require the units themselves to be 'financial products'.

Taxation

- A full review of tax amendments is needed
- There are concerns emerging about the FIFO method and why it is compulsory. In its current form and in combination with a historical cost valuation, it may encourage tax driven choices to surrender permits by 30 June for those companies that have this tax year, whereas their final acquittal date is 15 December
- There is uncertainty about the matching up of liable entities, operational control and permit allocation and whether there could be tax implications
- GST is a significant issue. It remains unclear why GST needs to apply at all.

Compliance

AIGN intends to do a review of the compliance process and cannot comment on it sufficiently at this time.

5.1.3 Bills omissions

AIGN has a number of concerns around the detail of regulations yet to be drafted across all areas of the CPRS including permit allocation and acquittal, coverage, emission methodologies, auctioning, and taxation.

- The Bills and regulations do not provide for a transparent process to determine the allocation of the national commitment among the CPRS and uncovered sectors
- International linking provisions are not in the Bills
- Trade exposed 'activity' definitions, allocation rates and operation of the transition arrangements are in regulations, providing no avenue for administrative and legal challenge
- Auctioning processes are yet to be revealed
- Operation of the Climate Change Action Fund is not in the Bills.

6 COMPLEMENTARY MEASURES¹⁹

AIGN has previously made detailed submissions to Australian governments on the greenhouse and energy policy and regulatory environment, including participating in consultation processes concerned with 'Reducing the Burden'²⁰, the Wilkins Strategic Review of the Australian Government's Climate Change Programs, IPART, and streamlining greenhouse and energy reporting.

The objective of developing a coherent and streamlined set of climate change measures across jurisdictions has long been requested by industry. In principle, this has been supported by Australian governments in successive iterations of a political commitment to a streamlining objective. However, in an overcrowded greenhouse and energy measures bandwagon – a 2008 audit by the Department of the Environment, Water, Heritage and the Arts has revealed over 140 Commonwealth and State (and Territory)²¹ measures – industry is yet to see any measure abolished and continues to witness the announcement of additional measures across jurisdictions with no regard for

¹⁹ Senate Select Committee on Climate Policy, Terms of Reference, 1(b) the relative contributions to overall emission reduction targets from complementary measures such as renewable energy feed-in laws, energy efficiency and the protection or development of terrestrial carbon stores such as native forests and soils;

²⁰ A streamlined national reporting framework for greenhouse and energy data: *Reducing the burden*, Australian Greenhouse Office consultation paper, April 2006

²¹ Greenhouse Challenge Plus review of climate change policy measures

co-ordination, national consistency or efficiency, and contrary to stated cross-jurisdictional intentions.

AIGN asserts that the measures of all jurisdictions are confusing and compromise the national framework required to meet the objective of reducing greenhouse gas emissions at least cost. Their existence is a critical consideration in understanding the measures required in addition to an emissions trading scheme and AIGN has urged the Commonwealth Government to take a strong lead in pursuing this agenda with States to no avail.

However, AIGN would note that the definition of ‘measures additional to emissions trading’ should be broad and cover policies, programs and regulations that include as their objective the reporting or reduction of greenhouse gas emissions or energy, the latter as a proxy for emissions. In the case of regulations, this would include any reference to greenhouse gas abatement for project approvals, and licensing processes and conditions. Given there will be a national emissions trading scheme there is no further need for project approvals and licensing to include the examination of greenhouse gas emissions. Specifically, and importantly, at the Commonwealth level, this includes any suggested amendment of the Environment Protection and Biodiversity Conservation Act (EPBC Act) to include a greenhouse “trigger”.

AIGN has advocated a competition policy style of agreement between the Commonwealth and the States and Territories. The agreement would see revenues withheld by the Commonwealth where measures retained or introduced by States are not consistent with a national emissions trading scheme as determined by the Productivity Commission.

6.1 Principles for complementarity

In her speech of 6 February 2008 to the Australian Industry Group²², Minister Wong identified three guiding principles that AIGN commends as being the underpinnings of an approach to developing a coherent and streamlined set of climate change measures:

- **An efficient and effective national emissions trading scheme will be ‘at the heart’ of emission reduction efforts.** Unless this is genuinely the case, most of the claimed economic efficiency,

environmental effectiveness and equity benefits of an emissions trading scheme will be lost;

- **Measures put forward to be additional to emissions trading must clearly identify and demonstrably address ‘market failures’.** AIGN commends the rigor of a ‘market failure’ test, as opposed to a soft ‘market barrier’ test, and recommends additional measures, whether existing or proposed, be subject to publicly transparent analysis to be carried out by an agency such as the Productivity Commission; and
- **Both the emission trading design and any additional measures must ‘reduce emissions at least cost’ and ‘push down the costs of emissions reductions’.**

The AIGN has long argued that, when a national emissions trading scheme is introduced, there will no longer be a case for a range of mandatory government measures directed at industry within or across jurisdictions. AIGN commends a ‘clean sheet’ approach to climate change measures – instead of merely assessing the array of existing measures against the principles; rather government should identify remaining market failure and design new effective measures. AIGN cautions against any attempt to customise existing measures to suit purposes for which they were not originally intended in an effort to retain their relevance.

Where existing mandatory Commonwealth and State measures overlap with and duplicate the national emissions trading scheme, they should be abolished or phased out from 2010. The property rights that would be extinguished where existing measures are no longer of value should be fully compensated.

The COAG endorsement in November 2008 of the *COAG Principles for Jurisdictions to Review and Streamline their Existing Climate Change Mitigation Measures*²³ was an overdue initiative welcomed by industry that mirrors the principles espoused by Senator Wong. The intent that the COAG Principles would underpin a review of a jurisdiction’s existing climate change mitigation measures is an important one, which has AIGN’s full support.

AIGN also recommends that a moratorium on new measures be put in place. AIGN argues for this across all jurisdictions.

²² Speech to the AI Group Luncheon, 6 Feb 2008, “*Climate Change: A Responsibility Agenda*”

²³ http://www.coag.gov.au/coag_meeting_outcomes/2008-11-29/index.cfm#tabs

6.2 Measures additional to national emissions trading

As mitigation of climate change requires a global solution, climate change policy and its implementation should be determined at a national level and, therefore, be the responsibility of the Commonwealth Government. The State and Territory Governments should focus on activities unique to their jurisdictions such as adaptation. All levels of government should focus on reducing emissions from their operations and the operations of their statutory bodies.

AIGN recommends that existing and proposed Commonwealth, State and Territory measures that impose costs on business should be assessed using the principles identified above and within the following framework:

- Measures that address market failures not effectively resolved by the emissions trading scheme;
- Measures that address emissions from sources or sectors that are not covered by emissions trading; or
- Existing measures that are in transition.

6.2.1 Market failures with emissions trading

The key rationale for emissions trading is that the price of permits will correct the market failure of un-priced greenhouse gas emissions. AIGN believes there is strong support for this proposition and that it implies that no additional measures should be required.

However, AIGN recognises that in both the global and domestic contexts, emissions trading alone, at least in its early implementation, is unlikely to be a sufficient policy response to tackle the array of national, sectoral and technology circumstances and challenges. In particular:

- **RD&D** – a policy prescription is demanded that is effective in stimulating RD&D beyond that which would be delivered by the private sector alone. There is evidence that, because effective emissions trading schemes exist by government fiat only, the sovereign risk this entails in terms of government control of permit price inhibits a socially optimal level of investment in RD&D (see for example Montgomery and Smith²⁴). AIGN suggests that a significantly expanded, public funded RD&D effort will be required;

²⁴ Montgomery, David W. and Smith, Anne E. 2005, *Price, Quantity and Technology Strategies for Climate Change Policy*, CRA International. Available from: www.crai.com.

- **Adopting frontier technologies** – AIGN’s view is that any sensible pathway to future emission reduction targets will imply imposing on the economy a relatively low emission penalty initially, then rising steadily and predictably (although not with certainty) over time. This price pathway, while inducing the adoption of innovative technologies when they are commercial at the expected emissions price, will not induce early demonstration and adoption of these technologies much before that time. However, it is not yet clear that emissions trading design will achieve this sensible price pathway, particularly with the unpredictability around when major developing countries take on targets and the implications this will have for permit price. In this imperfect market, there will very probably be new projects across the economy that, if provided with a financial incentive, would be prepared to take on the additional risk of frontier technologies earlier than is commercially dictated by the emissions trading scheme. Governments may need to address this opportunity with financial incentives;
- **Energy market reform** – there remains work to be done on reforming Australian energy markets, including addressing related regulatory and taxation policies that inefficiently influence those markets. Unless all consumers are exposed fully to the energy cost ramifications of their activities, then the economic efficiency and environmental effectiveness of adding to those costs through an emissions trading scheme could be severely compromised. Governments should resolve these issues before implementing an emissions trading scheme;
- **Programs to inform the market** – it is very likely that an emissions trading market will take several years to mature. Not only will those liable to acquire permits need education in how to measure, monitor and verify their emissions, they will need education in the workings of auction markets and secondary markets. Further, although they are unlikely to be required to acquire permits, the general community needs to be informed about how permit prices translate into higher energy and other product prices, and the measures they can adopt to reduce their consumption.

6.2.2 Emission sources and sectors not covered by emissions trading

AIGN advocates inclusion of all gases, sources and sectors in the emissions trading scheme. Where there are exclusions at the beginning of the scheme, the legislation

should identify a clear timetable for inclusion. AIGN expects that the emissions trading scheme will be comprehensive within just a few years of its beginning and consequently does not advocate additional measures associated with initial exclusion, including the creation of credits.

Should AIGN's optimism be misplaced, AIGN urges the development of measures that would send an equivalent price signal to emitters that are not covered by the emissions trading scheme. These measures should be in place at the same time as the emissions trading scheme and be developed in full consultation with affected industry.

6.2.3 Measures in transition

The emissions trading scheme will comprehensively address the market failure that is the claimed object of renewables target schemes, natural gas target schemes, electricity emission benchmark schemes, feed-in tariffs and other subsidy schemes for proven technologies. However, AIGN is aware that some of these schemes have created property rights that must be either protected or fully compensated. In the absence of full compensation, AIGN recommends that the schemes be fully phased out by 2020 starting from the time emissions trading commences.

In relation to Commonwealth measures that are imposing costs on industry, AIGN has identified three for special comment in this submission. This should not be taken to imply acceptance of all other Commonwealth measures – on the contrary, AIGN assumes they will be abolished.

Mandatory Renewable Energy Target

The Commonwealth's mandatory Renewable Energy Target (RET) fails all three of Minister Wong's principles:

- RET will crowd out the adoption of economically efficient investment in new electricity generation capacity for the next 20 years and defeat emissions trading as the 'heart' of emission reduction in that sector;
- Once there is an emissions price established by emissions trading, there is no market failure for RET to address;
- As all modelling and the operation of MRET has shown, RET is demonstrably not least-cost.

Nevertheless, AIGN recognises that the 9,500GWh MRET, and perhaps 3,500GWh of the 20,000GWh renewables targets proposed by the States, have created property rights that need to be respected by governments. As a second best option, AIGN recommends that the least-cost and equitable solution would be a national RET scheme that has the following features:

- The scheme should terminate in 2020 as is currently legislated;
- The mandatory target should be ramped-up from 9,500GWh in 2010 to 13,000GWh in 2020;
- From 2010, the RET penalty of \$40/MWh, which caps the subsidy and hence the inefficient cost of the scheme, should be annually reduced by the \$/MWh equivalent of the emissions trading permit price;
- Consistent with the design of many of the State schemes, the amount of electricity consumed by emission intensive, trade exposed industry should be excluded from the assessment of those liable to meet RET targets.

Energy Efficiency Opportunities

With an emissions trading scheme there will be no market failure case for mandatory energy-efficiency programs targeted at industry to address. Further, these measures become an unnecessary compliance burden, which distracts companies from directly focussing on their obligations under an emissions trading scheme. In that context the Energy Efficiency Opportunities program should be terminated when the program reaches its first review period in 2011. The same result needs to be enforced for State based mandatory energy efficiency measures.

7 CONCLUSION

AIGN acknowledges the terms of reference of the Committee, particularly its recognition that climate policies need to:

- reduce carbon pollution at the lowest economic cost,*
- put in place long-term incentives for investment in clean energy and low-emission technology, and*
- contribute to a global solution to climate change;*

AIGN is principally concerned with the development of climate policy that delivers these same objectives. These

objectives have been previously articulated by the Rudd government. In discussing the design principles that should underpin the development of emissions trading scheme the Minister for Climate Change, Penny Wong said,

“... The introduction of a carbon price ahead of effective international action can lead to perverse incentives for such industries to relocate or source production offshore. There is no point in imposing a carbon price domestically which results in emissions and production transferring internationally for no environmental gain.”²⁵

AIGN notes, as the Minister has on behalf of the government, that Australian domestic action that has no global environmental gain, at the expense of our own prosperity and growth, is counterproductive to the ideal of long term emissions reduction to avoid dangerous climate change

AIGN would urge that future negotiations of Australian commitments under an international framework should not be compromised by decisions made by governments with respect to a domestic policy agenda. Australia’s share of global emissions are such that there will be little gained by adopting comparatively harsh domestic emission trajectories or budgets prior to the successful negotiation of a new international framework. Accordingly, Australian domestic policy will need to be flexible to account for changes in knowledge and international circumstances, whilst accommodating the management of uncertainty so that industry can make sound investment decisions.

AIGN contends that properly designed, an emission trading scheme can deliver the objective of emissions reduction at lowest possible cost. However, the CPRS Bills do not do the job, particularly for trade exposed and strongly affected industries.

Further, industry support for the introduction of an emissions trading scheme is contingent on the removal of the large number of prescriptive and economically inefficient policies that are currently used to regulate greenhouse gas emissions from industry.

It is possible however, that with amendment, the CPRS can be resurrected to deliver Australia’s fair share of global emissions abatement, while supporting the

competitiveness of those industries which underpin Australia’s economy, and current and future prosperity.

AIGN would be pleased to elaborate its proposals to the Committee if required.

²⁵ Speech to the AI Group Luncheon, 6 Feb 2008, *Climate Change: A Responsibility Agenda*

Attachment A: AIGN Membership

Industry Association Members

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

Individual Business Members

Alcoa of Australia Limited
 Adelaide Brighton Cement
 Bluescope Steel Ltd
 BP Australia Limited
 Caltex Australia
 Cement Australia
 Chevron Australia Pty Ltd
 CSR Limited
 ExxonMobil
 Hydro Aluminium Kurri Kurri
 Inpex Browse Ltd
 Leightons Holdings
 Origin Energy Limited
 Qenos Pty Ltd
 Rio Tinto Australia Limited
 Santos Limited
 Shell Australia Limited
 Tomago Aluminium
 Thiess Pty Ltd
 Wesfarmers Limited
 Woodside Petroleum Limited
 Xstrata Coal Australia Pty Ltd



**AUSTRALIAN
INDUSTRY
GREENHOUSE
NETWORK**

**T +61 2 6295 2166
www.aign.net.au**

