

Business
Council of
Australia



Business Council of Australia

**Submission to the
Select Committee on Climate Change Policy**

on the proposed

Carbon Pollution Reduction Scheme

**The Secretary
Senate Select Committee on Climate Policy
PO BOX 6100
Parliament House
CANBERRA ACT 2600
Climate.sen@aph.gov.au**

April 2009

Table of Contents

EXECUTIVE SUMMARY	3
INTRODUCTION.....	4
THE ROLE OF AN EMISSIONS TRADING SCHEME IN AUSTRALIA'S RESPONSE TO CLIMATE CHANGE.....	5
THE SETTING OF AUSTRALIA'S EMISSIONS REDUCTION TARGETS.....	8
THE DESIGN OF THE CARBON POLLUTION REDUCTION SCHEME	10
THE ROLE OF COMPLEMENTARY POLICIES IN RESPONDING TO CLIMATE CHANGE.....	17
DRIVERS OF FUTURE INVESTMENT	19
CONTACT.....	21

EXECUTIVE SUMMARY

The BCA's vision is for Australia to be the best place in the world in which to live, learn, work and do business and for it to become and remain a top-five economy among OECD countries by 2012. The overriding objective is to enhance prosperity in Australia.

The BCA makes this submission giving consideration to Australia's long-term economic prosperity, as it is the strength of Australia's economy and viability of Australia's businesses which will ensure we are able to respond to economic, social and environmental challenges.

Australia is on a path to implement policy reforms in response to the risk of anthropogenic global warming. These will include the introduction of an emissions trading scheme at a time of a sudden and severe downturn in the global economy which in turn has brought significant uncertainty about Australia's short-term economic outlook, with likely flow on concerns for example due to the terms of trade impact over the medium term.

In light of this, legislation for an emissions trading scheme and its implementation especially in the early years, will require a tailored approach aligned to global and national economic conditions and designed to ensure Australia's industry and employment opportunities are not adversely impacted.

INTRODUCTION

The Business Council of Australia (BCA) represents the chief executives of over 100 of Australia's leading companies across all major industry and business sectors. The BCA develops and advocates, on behalf of its members, public policy reform that positions Australia as a strong and vibrant economy and society.

The businesses that the BCA members represent are amongst Australia's largest employers and represent a substantial share of Australia's domestic and export activity. Therefore they have a significant interest in the scope and direction of public policy and economic reform.

The BCA's vision is for Australia to be the best place in the world in which to live, learn, work and do business and for it to become and remain a top-five economy among OECD countries by 2012. The overriding objective is to enhance prosperity in Australia.

The economic, social and environmental risks are substantial both if we take no action on global warming and if we take the wrong action.

Australia should take a long-term and risk management approach to global warming which incorporates both mitigation and adaptation elements, is calibrated to international responses and builds on our skills, resources and regional location.

This can best be done through a well-designed emissions trading scheme that can be linked internationally over time and that includes mechanisms to both address competitiveness risks in the absence of a global price on greenhouse emissions and support the smooth transition of Australia's electricity sector to low emissions technologies.

What is evident now, given the scale and projected duration of the global economic downturn and the severe and sudden deterioration in economic and financial circumstances in Australia, is the need to not only get the details of the CPRS right, but to calibrate the introduction and operation of the CPRS to ensure it does not exacerbate the impact of the economic downturn, impact on competitiveness and employment or unduly slow the recovery in economic growth.

This submission considers:

- the role of an emissions trading scheme in Australia's response to climate change;
- the setting of Australia's emissions reduction targets;
- the design of the Carbon Pollution Reduction Scheme;
- the role of complementary policies in responding to climate change; and
- drivers of future investment.

THE ROLE OF AN EMISSIONS TRADING SCHEME IN AUSTRALIA'S RESPONSE TO CLIMATE CHANGE

Decisions related to climate change policy and action should be developed taking account of the following six critical considerations:

1. An effective, sustainable response to climate change is ultimately about moving from our current high-emission global economy, of which Australia is part, to a low-emission global economy. This is a complex transition which will impact all nations and the communities and business of these nations.
2. The challenge of controlling emissions and hence climate change will be won or lost at a global level. Developing countries will likely contribute 70 per cent of the growth in future world emissions, and will soon be the source of the majority of world emissions.
3. The most effective system to reduce emissions is one primarily based on a market solution. Market structures provide the basis for the identification of least-cost solutions and build in the incentives to innovate.
4. Given the scope and scale of the transition implicit in effectively reducing emissions, a multifaceted approach is essential. While a market-based solution is the primary vehicle, other supporting policies and initiatives will be required to ensure the research and development necessary to identify technology solutions including low-

emissions technologies, improve energy efficiency and build Australia's adaptation capabilities.

5. The necessity of a globally based solution does not mean Australia cannot make a significant contribution to such a solution, or demonstrate leadership by formulating responses that can be used as a template or guide for other countries to adopt.
6. Australia can and should implement strategies nationally which:
 - reduce emissions relative to a business-as-usual outlook;
 - ensure the abatement is that which is lowest cost;
 - include arrangements to address the impacts on emissions-intensive, trade-exposed industries in the absence of a global carbon price;
 - prevent adverse impacts on the competitiveness of Australia's emissions-intensive, trade-exposed industries in the absence of a global carbon price;
 - ensure the risk of carbon leakage, that is, the export of greenhouse gas emissions and related employment is prevented;
 - facilitate the long-term and smooth transition of the electricity sector to low-emissions technologies;
 - provide investment certainty to enterprises and investors; and
 - spread the costs of the transition to a low-emissions economy, particularly as Australia acts ahead of other nations, across the community ensuring low-income households are assisted.

There exist two alternative risk management paths that can be taken in response to global warming and the need to reduce greenhouse emissions. The first of these is to put in place a price on carbon through a market mechanism, and the second is to introduce an array of policies based on mandatory targets, subsidies, tax incentives, prohibitions and regulations.

The BCA identified in its publication *Strategic Framework for Emissions Reduction* (2007) that to be economically effective market based approaches should be pursued. The BCA gave consideration to both emissions trading and emissions taxes.

Market-based mechanisms provide a major economic benefit over governments determining where abatement should occur through the implementation of mandatory targets, subsidies, tax incentives, prohibitions and regulations.

Governments cannot know the marginal abatement costs of all, or even the main, sources of abatement. If governments determine the sources of abatement they will not be those that are lowest cost.

However, a market mechanism such as an emissions trading scheme or an emissions tax should lead to an efficient economic response. Where they differ is in terms of the certainty of abatement, and their implications for equity or the distribution of the benefits and costs from any scheme.

An emissions tax essentially seeks to determine the detrimental effect of greenhouse emissions (or externality) and tax them so that emitters face the full cost (the actual cost plus the tax or externality cost) of their actions.

An emissions tax will therefore set the price for greenhouse gas emissions, whereas the level of abatement is an impact of that price. The complexity arises in ensuring the price will lead to the level of emissions reduction the government agrees as a signatory to the Kyoto Protocol. There is the risk of multiple tax rate changes in getting to this target and the risk of not reaching the target or the government having to expend further funds purchasing international permits.

Under emissions trading the level of emissions is determined by the number of permits available in the market. The price for these permits will vary according to demand.

An emissions trading scheme provides the basis for companies to determine their risk and identify the most cost effective way to respond using a secondary market in permits.

It is for these reasons the BCA has recommended the introduction of an emissions trading scheme rather than an emissions tax.

What remains critical are the design details and the manner in which the scheme is introduced, given the scheme will be introduced in the absence of a global price on emissions and when there is a significant economic downturn.

THE SETTING OF AUSTRALIA'S EMISSIONS REDUCTION TARGETS

A prosperous Australian economy will be essential to dealing with the consequences of action taken to reduce greenhouse gas emissions and transform a high emission global economy to a low emission global economy.

Key steps to ensuring the sustainability of Australia's economy while addressing climate change will be:

- to take actions recognising Australia's contribution to global emissions;
- move in concert with international action; and
- include processes that address competitiveness risks where other countries do not have a price on greenhouse gas emissions.

As noted by Professor Ross Garnaut, Australia taking unilateral action ahead of other major emitting nations will not of itself make a significant contribution to global reductions so the critical issue remains – setting national emissions reduction targets that indicate Australia's resolve to assist in emissions reduction but not to do this in a manner that adversely affects Australia's competitiveness, capacity to make a smooth transition to low-emissions technologies in the electricity and other sectors and sustain investment and economic growth.

Australia can establish credible targets that provide the basis for a smooth, long-term transition to a low-emissions economy and which recognise the unique features of the Australian economy, international progress in emissions reduction and our contribution to global emissions.

There is not currently a comprehensive global agreement to reduce emissions by set amounts in future decades. Without this underpinning, any targets that Australia sets must weigh a range of factors:

- targets should take into account what is actually occurring internationally;
- targets should be credible and sustainable;
- targets should be technically feasible;

- the costs associated with achieving these targets should be understood by the community; and
- targets should be long-term in nature so as to support forward price discovery, reduce uncertainty and allow for better risk management with the caveat that there also exists a well-understood and transparent review mechanism that allows for the consideration of changes such as knowledge of the climate science or the level of international target setting.

The government has announced targets and target ranges for both 2020 and 2050.

While some have suggested these targets are modest, it must be recognised that they represent a substantial commitment on behalf of business and the community.

The 2020 target range set for Australia of –5% to –15% represents a reduction of between 25 per cent to 35 per cent relative to expected trends and a 34 per cent to 41 per cent reduction from 1990 per capita emission levels. Such targets are greater than those proposed by the United States Government, United Kingdom Government and the European Union.

The electricity sector must play a significant role in achieving Australia's emissions target given the proportion of emissions associated with the sector.

What must be recognised, though, is that there is a physical limit to the maximum rate at which the electricity sector can reduce its emissions.

In the BCA publication *Modelling Success: Designing an ETS That Works* it was noted that achieving a 10 per cent reduction in emissions from 2000 levels by 2020 will be extremely challenging for the electricity sector. It is estimated that such a reduction will require at least \$4 billion per year – a near-doubling of investment in new generation and transmission lines, compared with recent levels.

The report also highlighted that many low-emissions technologies are still under development and will not be available to any substantial degree until after 2020 and that under the most credible scenarios for capacity growth:

- Gas use for electricity must approximately triple. This will require significant development of undeveloped and, as yet, undefined Bass Strait reserves.

- Installed wind generation capacity must rise approximately sixfold. New wind generation must be built at a rate of 600 megawatts per year.
- At least 1350 megawatts of geothermal energy must be built, although this technology has not yet been demonstrated on a commercial scale.
- More than 500 megawatts of biomass capacity must be built, although biomass generation has failed to grow in recent years.
- More than 1000 megawatts of concentrated solar or carbon capture and storage (CCS) facilities must be built, although neither technology is currently in production and CCS may not become viable by 2020.

Clearly, success in reducing emissions from electricity generation will be a critical element in achieving the government's targets. As important will be the capacity for industries to invest in new production methods and processes. In light of this, clear policy directions and the availability of capital for investing will both be essential underpinnings to success in achieving Australia's emission targets. This matter is discussed in some detail later in this submission.

THE DESIGN OF THE CARBON POLLUTION REDUCTION SCHEME

In December 2008, the government provided the final model of its CPRS and emissions targets for 2020. Subsequently on 10 March 2009 the government released the exposure draft legislation to implement the Carbon Pollution Reduction Scheme.

This section of this submission reflects the initial review of the exposure draft and provides commentary on critical matters related to the drafting. It should be recognised that there has been a very short time frame in which to prepare this submission and the BCA will continue its assessment and commentary in coming weeks. The table below highlights aspects of the exposure draft and initial BCA views.

Defining the Objects of the Act and parts of the Act	<p>The objects do not fully reflect the government's stated policy intentions.</p> <p>The objects of the Act should be expanded to make clear the intentions of the Act also include:</p> <ul style="list-style-type: none">• putting a price on emissions
--	--

	<ul style="list-style-type: none"> • maintaining competitiveness as well as addressing the risk of carbon leakage • offsetting asset value loss in the electricity sector • replacing other government policies and programs that do not support least cost emissions reductions • trigger/test for moving from 5 per cent to 15 per cent as emissions target <p>The objects of part 8 should be broadened to make specific reference to offsetting competitiveness impacts in individual industry sectors and having consideration for the measures implemented in those sectors in competitor countries. It should also include a specific reference that EITE transition arrangements will be maintained in an industry sector where international competitors do not introduce equivalent measures.</p> <p>The objects of part 9 should be redrafted to ensure this section provides for the offsetting of asset value loss in the electricity sector.</p>
Setting 5 year caps and 10 year gateways Part 2	<p>The Bill and related documents do not include reference to the process that will be used over time to share the national commitment between the CPRS and uncovered sectors.</p> <p>There is a need to define a range of matters referred to in this part. In particular it should be made clear what the tests will be for major economies and advanced economies.</p> <p>The grounds for the reference to consideration of voluntary action need to be made clear.</p>
Safety cap Part 4 Division 2 section 89	<p>The time limit on the price cap should be removed.</p> <p>The Part should include an object which specifies the role of the price cap and that it will be ongoing unless otherwise determined in the 5 yearly reviews.</p>
Prohibition of sale of Australian emissions units Part 4 Division 3	<p>Is it anticipated that this prohibition will be lifted when appropriate by amendment rather than by including a provision referring to this in the Act?</p> <p>There should be an additional section which states government will give a minimum of 5 years notice of a decision to lift the prohibition and the decision should be made following a review by the Productivity Commission which includes a cost benefit analysis of such linkage and analysis of the likely impact of the Australian price of permits as well as the range of other issues raised in the white paper.</p>
Borrowing limits Part 6 Division 3	<p>Section 130 (4) (b) limits borrowing of permits to 5 per cent of the future vintage. The BCA proposes that this limit be increased to provide flexibility given the scope for annual fluctuations in emissions at an individual facility level, e.g. taking facilities off line for extended periods for maintenance.</p>
EITE arrangements	<p>The Act should include the key policy principles and design parameters related to the EITE arrangements.</p>

<p>Part 8</p>	<p>The objects of part 8 should be broadened to make specific reference to offsetting competitiveness impacts in individual industry sectors and having consideration for the measures implemented in those sectors in competitor countries.</p> <p>It should also include a specific reference that EITE transition arrangements will be maintained in an industry sector where international competitors do not introduce equivalent measures.</p> <p>The Act, rather than the regulations, should also include the principles to be used to assess eligibility, rate of permit allocation, and process to be used for additional requests for assessment as an EITE.</p>
<p>Coal-fired electricity generation Part 9</p>	<p>The objects of part 9 should be redrafted to ensure this section provides for the offsetting of asset value loss in the electricity sector.</p> <p>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 modelling.</p> <p>Consideration of issuing 10-year forward dated permits should be considered.</p> <p>In respect of the proposed auctioning of permits, deferred payment arrangements and or the actual auction design should in the Act or regulation result in a situation where the CPRS does not impose any additional working capital burdens on scheme participants.</p> <p>The windfall gains test should be assessed against the 'net revenue' loss over the pre-CPRS expected life of the asset, rather than the proposed 15 year period.</p>
<p>Independent Reviews Part 25</p>	<p>It is proposed that these reviews be undertaken by the Productivity Commission or panel membership include a Productivity Commission Commissioner with access to the expertise of the Productivity Commission.</p> <p>The matters to be reviewed should explicitly include:</p> <ul style="list-style-type: none"> • reference to whether EITE arrangements are maintaining industry sectoral competitiveness; • review of what policies have been put in place in competitor countries in each industry sector to put a price on carbon; • review of electricity sector reliability; and • economic impact of the CPRS <p>These provisions should be expanded so that an EITE individual company or industry sector can make an appeal for a review by the panel to determine whether the provisions of the scheme will maintain competitiveness at the level that existed prior to the scheme.</p>

Tax and accounting issues Consequential amendments Bill	The BCA is still considering these matters.
Relationship with National and Energy Reporting System (NGERS) legislation	<p>An initial review suggests that there will need to be changes to the NGERS to reconcile on matters such as reporting requirements, aligning NGERS with any changes following review periods.</p> <p>It is also proposed that NGERS be amended to such that in the early years (first 5 years) of the operation of the CPRS third party audits of large emitters be carried out in a staged manner so as to allow for building of competence and confidence and that after that external audits should not be mandatory but rather the regulator require such audits on the basis of risk or suspicion of non compliance.</p> <p>The CPRS provides for the transfer of liabilities to the entity with financial control, however NGERS does not provide this flexibility. NGERS should be amended to provide a definition of operational control for the mining industry and allow the flexibility to commercially negotiate emissions reporting obligations.</p>

It should be noted that this submission does not address a number of critical matters as the information is not yet available. These include:

- EITE activity definition, allocation (effective rates of) and operation of the transition arrangements.
- Decay rate as it applies to EITE activities.
- Impact of the renewable energy target on EITE industries unknown at this stage.
- Auctioning process.
- Availability of a deferred payment arrangement.
- Treatment of permits and the implications of their status as financial products.
- Excise tax adjustment related to fuel.
- Processes for international linkage.
- Operation of the Climate Change Action Fund.
- Household assistance package.

A further outstanding matter is the treatment of coal mining. This activity was excluded from the EITE transition arrangements though it appears to meet the threshold tests. The reason given for this decision related to the range of fugitive emissions levels across the different mine sites.

Rather than excluding mining from the EITE arrangements the specific concern of the range of emissions levels should be addressed.

A related matter is that of Scope 3 emissions where coal is an input into other EITE products.

Given the government's current intention is not to provide assistance for Scope 3 costs, including emissions from coal, there is a need to ensure whatever arrangements are put in place for coal mining do not lead to an increased cost pass through to those industries where coal is a key input.

The current proposal to provide coal mines with access to a limited pool of funds to address emissions reduction will not, of itself, address the risk of cost pass-through. These funds are unlikely to offset all costs coal mines will face with the introduction of the CPRS, leading coal mines to seek recovery via cost pass through to EITE customers who, in turn, will not receive any assistance for Scope 3 costs.

Many critical elements of the CPRS will be included in regulations. Business will not be able to assess the full impact of what is proposed until it sees both the draft Act and related regulations. This brings into question the proposal that the Act be passed before the regulations have been considered.

With the implementation of the CPRS, businesses and households will face changes in their cost structures unless they are able to offset the direct and indirect impacts of the energy price increases.

For some businesses these costs will be substantial and addressing them will require investment to manage the impacts and reduce emissions.

The approach taken to EITE industries under the CPRS in the exposure draft does not totally offset the impacts of the CPRS on the competitiveness of these industries and the inclusion of an annual reduction in permits available to these industries i.e. the decay rate

is an additional impost on these industries who will already be purchasing between 10 per cent and 40 per cent of permits.

Overall, for EITE industries the combination of having to purchase 40 per cent and 10 per cent of their permits, the annual reduction in permits allocated and the increased price of carbon will still result in additional costs that they are unlikely to be able to pass onto their customers in the absence of key competitors facing a comparable carbon price. These additional costs on EITE industries will adversely impact their business operations, in some cases reducing competitiveness and returns.

Low-emissions technology development and deployment in the electricity sector will be essential to ensuring Australia can contribute to global emissions reduction.

While the exposure draft has provided mechanisms to support the transition of the electricity sector to low-emissions technology, it is of concern that the level of transition assistance described is unlikely to achieve this outcome without risks to reliability and supply of electricity, and the level is unlikely to create an environment that facilitates new investment in electricity infrastructure.

Assistance to the electricity sector is required to ensure there is not an immediate reduction in generators' credit ratings and/or breaches of financial ratios (following on from the immediate loss in asset value) as this impact on the operations of the electricity market. It is worth noting that the number of Australian Emission Units (AEUs) with no charge applied to them for the entire electricity sector represent only 13 per cent of its total greenhouse gas emissions, and less than a third of the asset value loss as forecast by two of the three modelling consultants appointed by Treasury.

Linked with this, coal-fired electricity generators face a potential requirement to source a material amount of additional working capital in order to fund the potential cash flows associated with the auctioning of permits. Particularly, in the current environment these additional funds may not be available and so any auction process should be designed such that any adverse working capital implications can potentially be eliminated. This may be achieved through a number of mechanisms including a deferred payment arrangement or through assigning a forward delivery (and settlement) date to permits auctioned.

The BCA is informed that there is at least \$5 billion of debt due to be re-financed between 2009 and 2012 by base-load coal-fired power plant in the NEM. The proposed change in law by the CPRS is likely to exacerbate the difficulty with re-financing this necessary infrastructure. The timing of the debt repayment, and cost of CPRS, may also cause difficulties for directors of a number of electricity businesses as to whether or not they are a 'going concern' (which in turn will affect their ability to trade). Connected with this, it is understood a number of electricity companies have recommended the government underwrite the debt for all coal-fired power plant.

There are four further issues which are outside the boundaries of the exposure draft but will have a major impact on the costs and operation of the CPRS.

The first is the plethora of federal and state based programs related to emissions reduction and the take-up of alternative forms of energy supply which have the potential to reduce the effectiveness of the emissions trading scheme, increase regulatory and administrative burden of business and prevent the attainment of least cost emissions reduction.

The second is the need to remove electricity retail price caps which remains an outstanding issue and will become more important as the full cost of CPRS, renewables, energy efficiency and other initiatives unfold.

The third is the requirement for clear policies that facilitate ongoing investment and support for research and development efforts related to low emissions technologies.

Fourthly the process of review of state stamp duties through COAG has been delayed and as a result there remains ambiguity as the states capacity to charge stamp duty on permit related transactions.

It will be important to address these matters in parallel to the introduction of the CPRS.

What is evident now, given the scale and projected duration of the global economic downturn and the impact in Australia is the need to not only get these details of the CPRS right but to calibrate the introduction and operation of the CPRS to ensure it does not exacerbate the impact of the economic downturn or unduly slow the recovery in economic growth.

THE ROLE OF COMPLEMENTARY POLICIES IN RESPONDING TO CLIMATE CHANGE

The BCA endorses the COAG decision that measures should be assessed against the following principles.

1. The measures are targeted at a market failure that is not expected to be adequately addressed by the Carbon Pollution Reduction Scheme or that impinges on its effectiveness in driving emissions reductions.

Complementary measures should adhere to the principles of efficiency, effectiveness, equity and administrative simplicity and be kept under review. They may include:

- a) Measures targeted at a market failure in a sector that is not covered by the Carbon Pollution Reduction Scheme.
 - b) Measures for where the price signals provided by the Carbon Pollution Reduction Scheme are insufficient to overcome other market failures that prevent the take-up of otherwise cost-effective abatement measures.
 - c) Measures targeted at sectors of the economy where price signals may not be as significant a driver of decision making (e.g. land use and planning).
 - d) Some measures in (a) or (b) may only need to be transitional depending on expected changes in coverage or movements in the carbon price.
2. Complementary measures should be tightly targeted to the market failure identified in the above criteria that are amenable to government intervention. Where the measures are regulatory they should meet best-practice regulatory principles, including that the benefits of any government intervention should outweigh the costs.
 3. Complementary measures may also be targeted to manage the impacts of the Carbon Pollution Reduction Scheme on particular sectors of the economy (for example to address equity or regional development concerns). Where this is the case, in line with regulatory best-practice, the non-abatement objective should be clearly identified and it should be established that the measure is the best method of attaining the objective.

4. Where measures meet the above criteria, they should generally be implemented by the level of government that is best able to deliver the measure. In determining this, consideration should be given to which level of government has responsibility as defined by the Constitution or convention/practice, the regulatory and compliance costs that will be imposed on the community, and how the delivery of the measure is best coordinated or managed across jurisdictions.

As discussed above what is not required is a plethora of state and federal programs and policies related to energy, energy efficiency and climate change as well as an emissions trading scheme.

An audit undertaken by the Department of Environment, Water and Heritage in 2008 indicated that there were over 140 such programs in existence at that time. Whilst there have been commitments to the review of these programs (Wilkins Review 2008, COAG 2008) there is no evidence of any rationalisation and wind up of these programs, all of which place additional costs on business and most of which will be unnecessary with the introduction of an emissions trading scheme.

As a priority the proposed expanded renewable energy target should not be introduced. The proposed expanded renewable energy target fails to meet the tests the government has prescribed for the introduction of policies that are complementary to the Carbon Pollution Reduction Scheme and the COAG complementary measures principles.

It would be appropriate to reconsider the policy objective to be achieved and whether there are other more appropriate policy tools to bring forward both renewable and low-emissions technologies without undermining the CPRS. Such policies could include targeted research, development and deployment initiatives to address specific challenges in technology development.

Whilst the CPRS should be seen as the key tool to support emissions reduction, there will remain a need to better understand and map Australia's adaptation agenda. This will require ongoing government support and community engagement.

Similarly there will remain a need to undertake ongoing research and development investment by government and business following the introduction of an emissions trading scheme.

DRIVERS OF FUTURE INVESTMENT

It must be recognised that the economic outlook has worsened since the release of the government's white paper on the CPRS both in terms of the depth of the economic decline and the likely duration.

The global economy has deteriorated rapidly and sharply, even compared with expectations in late 2008. Global growth contracted at an annualised rate of 5 per cent in the December quarter of 2008.

The most recent IMF forecasts are for a contraction of growth in the major advanced economies of between 3 and 3.5 per cent in 2009. This will be the first contraction in economic activity in those economies since World War II.¹ This compares with a forecast for growth of 1¼ per cent less than 12 months ago.²

Global growth is now projected by the IMF to contract by 0.5 to 1.0 per cent in 2009, compared with growth rates of 3¾ per cent in 2008 and 5 per cent in 2007. This is a very significant slowdown. In April last year, the IMF was predicting that the global economy would grow in 2009 at a still-healthy 3¾ per cent.

The United States, Japan, the United Kingdom and European Union are in recession. The economies of China and India are also expected to slow. Projections at this stage are for relatively modest reductions in growth, although more recent information provided by the IMF, OECD and the World Economic Forum suggests that China, in particular, may be slowing by more and much faster than expected.³ This suggests that further downward revisions in economic forecasts around the world are likely.

¹ International Monetary Fund (IMF), 'Advanced Economies to Contract Sharply in 09, Upturn Next Year –', *IMF Survey Magazine*, 19 March 2009.

² IMF, *World Economic Outlook*, April 2008.

³ Between October and January 2009, the IMF revised downwards its 2009 forecasts for growth in China from 9.3 per cent to 6.7 per cent and for India from 6.9 per cent to 5.1 per cent. The OECD has warned of a 'strong slowdown' in China (OECD, 'Composite Leading Indicators Signal Deep Slowdown in OECD Area and Major Non-OECD Member Economies', news release, 12 January 2009, Paris).

Australia entered this difficult period from a stronger position relative to other countries on the back of seventeen years of sustained economic growth, record lows in unemployment, fiscal surpluses and low levels of public debt. The decline in GDP in the December quarter of 0.5 per cent demonstrated however that these strengths only provide a limited shield from the global situation.

Where just a year ago excessive demand was exposing Australia's supply constraints, we now find economic demand needs support.

Rising capital costs and pressure on cash flows are now significant issues across business and will impact the capacity to manage the impacts of the CPRS. In this environment, additional uncertainty and risk will adversely affect investment decisions.

Key drivers of future investment will be the degree to which the viability of businesses is impacted on by the current economic climate; the nature of Australia's broader economy policy framework; the predictability of the policy environment in which businesses will be operating in the future; and the operation of the CPRS especially in the years before there is a global price on emissions.

In light of these factors key considerations include:

- policy interventions in response to the global financial crisis;
- policy outcomes following the current taxation review;
- CPRS design details such as:
 - Whether the provision of 5 years of fixed caps and ten year gateways are sufficient for major new long life investments.
 - Ensuring the cost impacts on EITE industries (in the absence of a global price on emissions) are not at a level that affect competitiveness and/or prevent investment in process improvements and new technologies.
 - Ensuring there is clear guidance as to the criteria for policy changes to any aspect of the scheme.
 - Ensuring the price cap continues for as long as required to provide confidence in long-term investment planning.

- ensuring asset values are not written down in a manner which prevents investment in alternative technologies.

Over time the implementation of Australia's CPRS does have the potential to provide many opportunities. A market driven price on carbon brings with it the potential for:

- the deployment of existing low-carbon technologies at greater rates across the economy;
- the development and scaling up of technology which is nearly at the commercialisation stage;
- incentives to find new breakthrough technological solutions;
- re-engineering many of the processes that underpin our current businesses;
- new employment opportunities and the reskilling of the workforce in response to new technologies; and
- the development of a new financial market and financial instruments to underpin the trading in permits.

However, to achieve these benefits, the implementation of the CPRS in Australia ahead of our competitors will require careful management and clear policies to address the transition years where there is not a global price on emissions.

There is little to be gained if in the early years of implementation there are unintended consequences such as 'carbon leakage', deferral of investment or business closures and employment losses.

CONTACT

The BCA has released a number of publications on climate change and emissions trading which address these matters in further detail. These publications are available at www.bca.com.au.

Please contact Maria Tarrant, Director Policy, Business Council of Australia, ph 0386642664 or maria.tarrant@bca.com.au with any queries you may have with regard to this submission.