Chapter 6

Transitional assistance

6.1 The CPRS package involves transitional assistance to companies heavily affected by the CPRS. There are two primary reasons. The first is to avoid 'carbon leakage'. The second is to assist firms to transit to operation in a carbon-constrained environment whilst maintaining energy security.

6.2 Firms engaged in emissions-intensive-trade-exposed activities may be constrained in their ability to pass through the increases in the carbon cost because they are price takers on the world market. Introducing carbon constraint ahead of other countries could lead to a loss of competitiveness for these industries and lead to 'carbon leakage'.[1]

Carbon leakage

6.3 Carbon leakage is most commonly expressed as a fear that having strict rules in Australia will lead to emissions-intensive industries shifting to countries without emissions caps and with the result of increased emissions or no global reduction in emissions occurring.

6.4 There are a number of conditions that must be in place before carbon leakage in this narrow sense would be likely to occur:

- the emissions permit price in Australia is a significant proportion of costs;
- there is no similar price currently being imposed in an alternative production centre;
- there is unlikely to be a similar price imposed in an alternative production centre for a significant proportion of the life of the project;
- there are not large relocation costs;
- there are not significant damages to the company's reputation from being seen to avoid responsibility for its greenhouse gas emissions[2];

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1 Department of Climate Change, *Assistance for EITE industries*, Fact Sheet, December 2008.

2 As a British expert witness put it of a firm relocating to avoid a carbon price, 'what they are saying is they would prefer not to take the responsibility as a member of society to reduce their emissions, to take their business somewhere else and freely to admit that which will cause harm to their own citizens. I cannot see that as evidence of leadership of any kind. I regard that as weak.'; Mr James Cameron, Executive Director, Climate Change Capital, *Proof Committee Hansard*, 19 March 2009, p 19.

- shifting production does not lead to offsetting increases in other ongoing costs (eg the transport of raw material from Australia, or higher prices for raw materials in the other centre); and

- the production process in the alternative centre is more emissions-intensive.

6.5 Another variant of 'carbon leakage' is where the Australian producer does not move offshore, but loses market share to an overseas competitor as a result of Australia introducing a price for greenhouse gas emissions. The relocation costs argument above does then not apply, but importantly the final point still does.

6.6 A number of witnesses asserted that there remains a risk of 'carbon leakage', notwithstanding assistance for emissions-intensive, trade-exposed industries (EITEs):

> A decay in the assistance rate over time will make cement produced in Australia uncompetitive compared to imported cement. If this leads to lower output from, or even the closure of Australian cement plants, offshore plants would increase production – hence carbon leakage.[3]

> The apparent cap on the allocation of permits to EITE industries (or activities) is inconsistent with the objective of preventing carbon leakage. This restrictive allocation is artificially circumscribing the extent of assistance available under the EITE measure.[4]

> This high cost impost poses a real risk of investments moving offshore, resulting in an economic loss to the Australian economy without any net environmental benefit as emissions would merely shift elsewhere.[5]

6.7 Other witnesses argued there was a widespread view that the problem of carbon leakage was greatly overstated.

6.8 As noted by the *White Paper*, work by the International Energy Agency suggests there has been little carbon leakage from the EU since their ETS was introduced.[6] The Committee asked an expert witness, James Cameron, from the United Kingdom about the European experience and was told:

> We are not experiencing significant competitiveness issues in any sector, even those most exposed to international competition…On the whole people do not move their businesses for these reasons…carrying the cost of carbon is not a significant factor.[7]

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3 Cement Industry Federation, *Submission 14*, p 4.

4 Australian Plantation Products and Paper Industries Council, *Submission 36*, p 2.

5 Ms Aileen Murrell, Chamber of Minerals and Energy of Western Australia, *Proof Committee Hansard*, 23 March 2009, p 3.

6 *White Paper*, p xxxiii.

7 Mr James Cameron, Executive Director, Climate Change Capital (UK), *Proof Committee Hansard*, 19 March 2009, p 22.

6.9 An ABARE study in 2007 found that only about an eighth of the reduced emissions in Australia may be offset by increased emissions abroad, even if Australia moved ahead of the rest of the world.[8] The Department of Climate Change summarised the evidence as follows:

> If you look at the experience in Europe, there is very little evidence to suggest that carbon leakage was a significant problem and, in the Treasury modelling, there is a suggestion that carbon leakage is unlikely to be a significant issue.[9]

6.10 A number of witnesses, including to this and other inquiries, have also questioned the likely extent of carbon leakage:

> Those [carbon leakage] arguments need to be robustly challenged, because they very rarely stand up to scrutiny.[10]
>
> We have a report…by independent experts…which looked in particular at aluminium and LNG, for example, and concluded that the concerns about carbon leakage were grossly overstated. [11]
>
> As for carbon leakage, the chance of this happening on any significant scale is virtually nil. As John Hewson once memorably told me, "You just don't throw an aluminium smelter in a backpack and take it off to Indonesia.".[12]
>
> Attempts to estimate carbon leakage empirically show significant variation…some studies report higher results…others point to minimal carbon leakage occurring. [13]

6.11 Alcoa indicated that, although they were seeking some further assistance for the most electricity intensive EITE industries, they were willing to work with the challenge of climate change imperatives:

> In terms of the efficiency of operating here in Australia, these are very, very long-life assets. I think the replacement value of the assets we have in Australia would be in excess of $20 billion. So they are not something that we would want to undermine, run down or walk away from easily. We have been here for more than 40 years. We want to stay for decades to come. So

8 A study by the Australian Bureau of Agricultural and Resources Economics, cited in Prime Ministerial Task Group on Emissions Trading, [Shergold] *Report*, May 2007, p 95.

9 Dr Martin Parkinson, Secretary, Department of Climate Change, *Proof Committee Hansard*, 18 March 2009, p 26.

10 Mr James Cameron, Executive Director, Climate Change Capital (UK), *Proof Committee Hansard*, 19 March 2009, p 26.

11 Mr Connor, Climate Institute, *Proof Committee Hansard*, 27 March 2009, p 45.

12 Dr Guy Pearse, 'Quarry vision: coal, climate change and the end of the resources boom, *Quarterly Essay*, no 33, 2009, p 55.

13 Dr Brian Fisher, 'A peer review of the Treasury modelling of the economic impacts of reducing emissions', Concept Economics, 30 January 2009, p 26.

> we will do whatever we can to maintain the competitiveness of the Australian industry.[14]

6.12 Dr. Richard Dennis from the Australia Institute believes that the argument that if emissions trading is introduced, there will be carbon leakage and corporations will exit the country as "absurd" arguing that if they were that mobile they would have been more likely to leave when our exchange rate was at US90c.[15]

6.13 The Department of Climate Change notes that the quantum of assistance in the CPRS can not be justified by carbon leakage arguments:

> …there is more support being proposed than is necessary to deal solely with the issue of carbon leakage.[16]

Transitional adjustment assistance

6.14 As noted above, the Department of Climate Change agreed that the assistance to EITEs was not based solely on the grounds of climate leakage. The other goal was described as follows:

> …the government is attempting to smooth the transition for individual firms, rather than just have them take a hit on their profit.[17]

6.15 Other submitters made an argument for transitional assistance:

> The draft legislation clearly demonstrates to us an appreciation of the fact that the Australian economy will require a period of transition to become a low-carbon economy. There is also a recognition of the potential competitiveness at threat for some aspects of the Australian industry. We can also see evidence in the legislation that the government has considered the emissions trading schemes in other jurisdictions and has looked to learn from the mistakes and some of the challenges that have been experienced with those schemes.[18]

> The overriding consideration for the AWU has been to ensure that the EITE industries most exposed to the impacts of the ETS, and least able to pass on costs associated with participation in the Scheme have the maximum level of assistance during the transition to an international framework for

14 Mr Timothy McAuliffe, Alcoa, *Proof Committee Hansard*, 23 March 2009, p 67.

15 Dr Richard Denniss, Australia Institute, *Proof Committee Hansard*, 25 March 2009, p 75.

16 Dr Martin Parkinson, Secretary, Department of Climate Change, *Proof Committee Hansard*, 18 March 2009, p 26.

17 Dr Martin Parkinson, Secretary, Department of Climate Change, *Proof Committee Hansard*, 18 March 2009, p .

18 Ms Amanda McCluskey, Colonial First State Global Asset Management, *Proof Committee Hansard*, 25 March 2009, p 48.

> emissions trading (which includes both developed and developing countries) on a true burden sharing basis.[19]

6.16 The transitional assistance is aimed at maintaining business confidence during the process of adjustment to a carbon-constrained economy and maintaining energy security.

6.17 The exposure draft legislation proposes to provide free permits to some EITEs. The permits provided will be based on the industry's historic average emissions intensity, avoiding penalising individual firms who are lower than average polluters and retaining an incentive for firms to cut emissions. Assistance will be linked to production: expanding firms will receive an increased number of permits and contracting firms will receive fewer permits. A firm which ceases to operate in Australia will no longer receive permits. To some extent this part of the CPRS operates like a 'baseline and credit' or 'intensity' system.[20]

6.18 Trade exposure will be assessed based on either having trade share (average of exports and imports to value of domestic production) greater than 10 per cent in any year 2004-05 to 2007-08 or a 'demonstrated lack of capacity to pass through costs due to the potential for international competition'.[21] Emissions intensity refers to emissions relative to either revenue or value added, averaged over the lowest four years from 2004-05 to 2008-09.

6.19 Initial assistance will comprise permits to the value of 90 per cent of the allocative baseline for activities with emissions intensity above 2000 t CO_2e per $million of revenue or 6000 t CO_2e per $million of value added. Permits to the value of 60 per cent of the allocative baseline for activities with emissions intensity of 1000 to 2000 t CO_2e per $million of revenue or 3000 to 6000 t CO_2e per $million of value added.

6.20 The *White Paper* suggests that, for example, aluminium smelting and integrated iron and steel manufacturing are likely to qualify for the 90 per cent assistance and alumina refining, petroleum refining and LNG production as likely to qualify for 60 per cent assistance. If the CPRS is extended to cover agriculture, it is likely that beef cattle, sheep, dairy cattle, pigs and sugar cane would qualify for assistance.[22]

6.21 Firms that are able to produce the same quantity of output with fewer permits than are provided will be able to sell the difference. In effect, they will receive credit for performance above the baseline. Firms with emissions above the baseline level will have to buy additional permits.

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19 Australian Workers Union, *Submission 27*, p 3.

20 The operation of 'baseline-and-credit' systems is described and critiqued in Chapter 11.

21 *White Paper*, p lxxv.

22 *White Paper*, p 12-45.

6.22 The 60 and 90 per cent assistance rates will be gradually scaled down over time, by 1.3 per cent a year.[23] However, the Government concedes that 'the share of permits provided to EITE industries will increase over the first 10 years of the scheme', perhaps to around 45 per cent.[24] As other countries introduce broadly consistent carbon pricing schemes, the assistance programme will be reviewed, but in general five years' notice will be given of any changes. The reviews may be informed by Productivity Commission reports on the Scheme's impact on particular industries.

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

> …if they are not emissions intensive then the costs they will face will be very low. If they are not trade exposed, that means that all participants in that industry in Australia will face similar costs and they can raise prices and pass it on to the community.[25]

6.24 In addition, there will be calculations of the impact of higher electricity prices resulting from the CPRS on various industries and if required further permits will be allocated to firms based on this.

6.25 In designing the assistance package, the Government is aware of the need to avoid subsidies that would place it in breach of WTO rules or undertakings under bilateral trade arrangements.

6.26 As with all redistributive measures, there will be differing perceptions of what is fair. The Secretary of the Department of Climate Change put it this way:

> This issue of balance is critical to achieving long-term sustainability for the scheme. The carbon market we are seeking to create is created by regulation, and ultimately rests on social consensus. Hence, a sense of fairness is absolutely critical, not only in its own right but because it contributes to the longer term policy goal. The value of permits in the emissions trading scheme can be used to help householders and businesses adjust to a carbon price. However, we need to bear in mind that assistance that we provide to one group is assistance that cannot be provided to another.[26]

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

24 *White Paper*, p xxxv. This is considerably above that in the *Garnaut Review*, which envisaged the proportion being less than 30 per cent and falling over time (p xxxii).

25 Dr Martin Parkinson, Secretary, Department of Climate Change, *Proof Committee Hansard*, 18 March 2009, p 17.

26 Dr Martin Parkinson, *Proof Committee Hansard*, 18 March 2009, pp 5-6.

Criticisms of assistance provided to EITEs

6.27 There have been two main groups critical of the assistance: companies who believe they should receive more assistance than envisaged under the CPRS and those who feel an excessive proportion of the (potential) revenue from the sale of permits is being returned to large polluters.

6.28 Some examples of the claims from aggrieved companies are:

> …all EITE activities should maintain their initial allocations of permits (ie 60 per cent and 90 per cent) until 80 per cent of all carbon emissions globally are covered by a comparable carbon constraint.[27]

> …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…remove allocation 'decay'…[28]

> …assistance measures for EITE industries in the CPRS should be amended to reduce the unbearable cost burden on the domestic steel industry…[29]

> …full allocation of permits for Australia's natural gas exports until competitor countries impose similar carbon costs; and removal of the 1.3% annual reduction in permit allocations.[30]

6.29 Many industry submissions argue that Australian firms will be unable to compete internationally if they are required to meet the cost of their carbon emissions while foreign competitors in the third world are not.[31]

6.30 Arguing that industry should be 'compensated' for the impact of the CPRS on competitiveness implicitly assumes Australia still has a fixed exchange rate so that any increase in costs must hurt competitiveness. However:

> you would expect a modest exchange rate depreciation as a result of the introduction of a scheme like this, so those that are not relatively emissions-intensive can in fact gain more from the exchange rate effect than they will face in additional costs.[32]

> …the Australian economy as a whole is not affected very much by whether we compensate trade-exposed industries. One of the things that happens is

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27 Rio Tinto, *Submission 63*, p 2.

28 Australian Industry Greenhouse Network, *Submission 54*, p 3.

29 Blue Scope Steel and OneSteel, *Submission 66*, p 2.

30 Woodside Energy, *Submission 95*, p 3.

31 See, for example, Ms Belinda Robinson, APPEA, *Proof Committee Hansard*, 24 March 2009, p 3; Cement Industry Federation, *Submission 14*, p 2; Alcoa, *Submission 44*, p 1; and BlueScope/Onesteel, *Submission 66*, p 2.

32 Mr Blair Comley, Acting Secretary, Department of Climate Change, *Proof Committee Hansard*, 30 March 2009, p 5.

> that we end up with a lower exchange rate, or a different exchange rate, so you end up encouraging some other export industries.[33]

The Garnaut approach

6.31 Professor Garnaut has a different proposal for industry assistance which is elaborated in the *Garnaut Review*. The key prescription is:

> For every unit of production, eligible firms receive a credit against their permit obligations equivalent to the expected uplift in world product prices that would eventuate if our trading competitors had policies similar to our own.[34]

6.32 Professor Garnaut's view is supported by his colleague Dr Jotzo. One of his criticisms of the CPRS approach is that, unlike that advocated by Professor Garnaut:

> …the scheme encourages continuation or indeed expansion of high emissions activities in Australia that would not be competitive in a world with comprehensive carbon pricing.[35]

6.33 A criticism of Professor Garnaut's suggestion is that calculating what price would prevail were foreign countries to adopt differing policies would be difficult in practice and could be seen as a matter of judgement. Dr Betz, an expert in emissions trading schemes, warned:

> The difficulty of this approach is in modelling that… Being an economist and knowing some of these models I know that they are all based on an assumption. So the difficulty is in practically implementing it.[36]

6.34 Furthermore, Professor Garnaut's approach would result in no assistance being provided to those firms whose emissions intensity is higher than the global average, for example aluminium produced with brown coal fired electricity.

6.35 Another criticism of giving away free permits to some industries is that it necessarily raises the burden on the rest of the community:

> …shielding trade-exposed industries also has the effect of redistributing the abatement burden to the non-shielded sectors within Australia, roughly doubling the carbon price required to achieve the same abatement and leading to an additional 0.4 percentage point reduction in GDP…[37]

> …the substantial share of the total permits is being allocated for free and that share is set to rise over time without any upper bound to the share of permits given out for free as total permits. That share given out for free will

33 Professor Ross Garnaut, *Proof Committee Hansard*, 23 March 2009, p 64.

34 *Garnaut Review*, p 345.

35 Dr Frank Jutzo, *Proof Committee Hansard*, 19 March 2009, p 30.

36 Dr Regina Betz, *Proof Committee Hansard*, 27 March 2009, p 121.

37 Prime Ministerial Task Group on Emissions Trading, [Shergold] *Report*, May 2007, p 95.

> be greater the stricter the target is. The upshot is, of course, that less money is available for assisting lower income households with higher energy bills and less money is available to invest for government investment in lower carbon technologies.[38]

Committee comment

6.36 The Committee supports the manner in which the issue of free permits to companies does not expand with their emissions, which retains incentive to reduce them. This is not a feature of the assistance provided in some other countries' assistance schemes.

6.37 The Committee notes that the many assertions by companies of the extent of carbon leakage have not been matched by much evidence that it will be as serious a problem as they claim. Payments of assistance can be justified to guard against carbon leakage and support emissions intensive trade exposed industries during the transition.

Additional assistance to the coal mining industry

6.38 The great majority of the coal mining industry is not emissions-intensive. There are a small minority of mines, the so-called 'gassy mines', which are very emissions-intensive. (Chart 6.1). The coal mining industry is unique in having such large within-industry variation in emissions intensity. This implies:

> Were you…to treat them as an emissions intensive trade exposed industry, you would provide a massive windfall gain to very large parts of the coal industry and you would not actually deal sufficiently with the problems that the gassy mines face.[39]

6.39 The Government accordingly decided to treat coal as a special case. This reasoning was not accepted by the black coal industry's representatives:

> Coal is eligible under the white paper rules for 60 per cent transitional assistance under the arrangements for emissions intensive trade exposed industries. Coal is well above the 1,000 tonnes of CO_2 per million dollars of revenue eligibility threshold, and we maintain that the decision to exclude it was a political decision. The coal industry is, therefore, seeking fair treatment not special treatment.[40]

6.40 The Australian Coal Association argued for additional support:

> I will just tell you that $5 billion over five years is our estimate of the cost of the CPRS to the coal industry. What we are being provided with is $750

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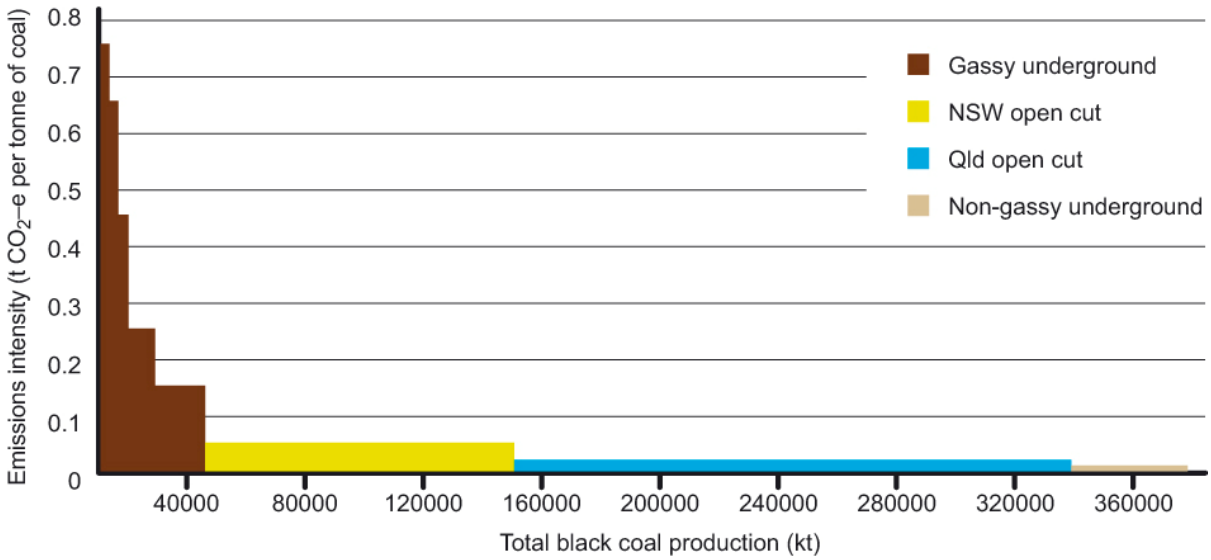
38 Dr Frank Jotzo, *Proof Committee Hansard*, 19 March 2009, p 30.

39 Dr Martin Parkinson, Secretary, Department of Climate Change, *Proof Committee Hansard*, 18 March 2009, p 14.

40 Mr Ralph Hillman, Executive Director, Australian Coal Association, *Proof Committee Hansard*, 25 March 2009, p 108.

> million…we are getting 10 per cent of our costs, LNG is getting 60 per cent, cement is getting 83 per cent and aluminium is getting 90 per cent. We believe we should be in there at the EITE with 60 per cent.[41]

Chart 6.1: Black coal mine fugitive emissions intensity (2006-07)



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

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

> …you just have to slightly adjust the white paper methodology to allocate the permits mine by mine, according to actual emissions rather than production, and the problem of windfall gains will immediately go away.[42]

6.42 However, adopting this approach would also mean that coal was being treated in a different way to other industries. Furthermore, if free permits were allocated in proportion to actual emissions, it would be eroding the incentive for coal mines to reduce their emissions intensity. A better approach is to ensure there are incentives for the gassy mines to introduce the available or support new abatement technologies, to reduce their emissions by concentrating and capturing, flaring or using coal mine methane.

6.43 The Government intends to allocate up to $750 million in targeted assistance to the coal industry, around two-thirds of which will go to 'gassy mines' to assist in the installation of abatement equipment.[43]

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41 Mr Ralph Hillman, Executive Director, Australian Coal Association, *Proof Committee Hansard*, 25 March 2009, p 110.

42 Mr Ralph Hillman, Executive Director, Australian Coal Association, *Proof Committee Hansard*, 25 March 2009, p 110.

6.44 An industry spokesperson has decried this level of assistance as inadequate:

> The coal industry was…offered token compensation of $750 million…the Government needs to urgently reconsider this decision.[44]

Committee comment

6.45 The Committee believes that a cogent case has been presented to explain why the form of assistance provided to the more homogenous EITE industries would have perverse effects in the coal industry due to the wide variety in the emissions intensities of individual mines. The proposed assistance is more appropriate than the suggestion of treating coal as an EITE industry. The application of the EITE thresholds broadly across the coal industry would put a disproportionate burden on other energy consumers including small business and households, including pensioners and low income households.

Additional assistance to industries producing lower emissions fuels and products

6.46 The liquid natural gas (LNG) industry made the point that natural gas is a cleaner burning material than other fuels. Although the industry uses energy to convert natural gas to LNG in Australia (thus increasing emissions locally), they argue that the CPRS does not take into account that LNG has the capacity to reduce greenhouse gases globally. LNG is 100% exported. The industry recognises that the industry has been given EITE status (at the 60% level) but put the case they should receive increased transitional assistance or complete exemption from the scheme on the grounds that they lower global emissions, will generate employment or other benefits to Australia and are highly trade exposed:

> LNG has been characterised as an anomaly within the emissions trading scheme design. Although producing LNG is emissions intensive and adds to greenhouse gas emissions in Australia, natural gas makes a substantial net contribution to reducing global greenhouse gas emissions. As the world inevitably shifts to a preference for cleaner burning fuels, the substantial strategic value of Australia's natural gas assets can only increase. APPEA therefore recommends that the draft Carbon Pollution Reduction Scheme Bill 2009 be amended to ensure that the LNG industry does not face any costs associated with a domestic emissions trading scheme while ever our competitors and our customers are not subject to similar imposts.[45]

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43 *White Paper*, p 12-46.

44 Mitch Hooke, Chief Executive, Minerals Council of Australia, cited in *The Australian*, 23 January 2009, p 1.

45 Ms Belinda Robinson, Australian Petroleum Production and Exploration Association, *Proof Committee Hansard*, 24 March 2009, p, 3.

6.47 There are also proposed LNG projects that will be more emissions intensive than the North West Shelf gas fields that the CPRS will use as the base to calculate the rate of EITE assistance for other projects.

Committee comment

6.48 The Government has set up an expert advisory committee, chaired by Mr Dick Warburton, to provide advice on arrangements for EITE assistance.[46] The Warburton Committee will provide advice on activity definitions and the delineation of boundaries around each activity for the purposes of EITE assessment. This will enable the LNG industry to put a case for individual projects.

Assistance to electricity generators

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

6.50 This assistance can not be justified to avoid carbon leakage as the power generators serve the domestic market and do not compete with overseas companies. They should be substantially able to pass on the cost of permits to customers (who in the case of low income households will be able to pay out of the assistance payments), but there may be some reduction in the value of their assets.

6.51 The Energy Supply Association of Australia argue that the $4 billion in assistance is not enough, and pointed to figures suggesting more than twice that amount:

> The proposed $3½ billion of assistance is insufficient and considerably lower than the consensus of modelling reports, which include two sets of government modelling reports, which suggest at least $10 billion of assistance is required in the first 10 years.[47]
>
> Insufficient assistance is likely to result in an immediate reduction in generators' credit ratings and/or breaches of financial ratios (due to the immediate loss in asset value). At the very least, a number of generators would be unable to meet the prudential requirements of their Australian Financial Services Licence and would be unable to trade…. This may result in a series of financial defaults throughout the market.[48]

6.52 No other submissions shared this view of steeply declining asset values. In the *White Paper*, the Government concluded that:

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46 Minister for Climate Change and Water, *Media Release*, 27 February 2009.

47 Ms Clare Savage, Chief Executive Officer, ESAA, *Proof Committee Hansard*, 24 March 2009, p 35. A similar view is put by Mr Wayne Trumble, Griffin Energy, *Proof Committee Hansard*, 23 March 2009, p 13.

48 ESAA, *Submission 21*, p 5.

> …..given the advice of the energy market institutions regarding the likely impact on the energy market, and the provision of assistance to the most affected generators through ESAS, it is very unlikely that the actions of creditors will pose a risk to energy security, as it will not be in their interests to take aggressive enforcement action, or to withdraw an asset from the market when prices would justify continued generation.[49]

6.53 The CPRS bill commentary notes that, in regard to ESAS assistance, the CPRS:

> …will impose a new cost on fossil fuel-fired electricity generators…relatively emissions-intensive generators are likely to face a greater increase in their operating costs than the general increase in the level of electricity prices…[and] lose profitability…if investors consider that the regulatory environment is riskier…all investments in the sector could face an increased risk premium.[50]

6.54 Some commentators have criticised the proposed assistance as unjustified handouts:

> There is no risk and there is no threat to those industries. In fact there is no doubt that if you did due diligence before you purchased such an asset, you would find that the due diligence suggested there was a risk in buying these assets of a significant carbon price. And given that most of the coal fired power stations in Australia have changed hands since that became obvious, the notion that anyone who bought those assets has been taken by surprise I think suggests that other people have failed in their duties. So to give billions of dollars to those groups is, I think, an egregious waste of taxpayers' money.[51]

> …with the electricity sector in both Victoria and New South Wales, if you did not see this coming, then you were asleep; if you did not see this coming, you were not doing your due diligence. In the case of Victorian generator owners, you were both greedy and silly.[52]

Committee comment

6.55 There is a legitimate concern that the provision of power to households not be disrupted during the transition to less carbon-intensive energy supplies. It is noted that no renewable energy sources are currently able to provide baseload power or rapidly increase production to meet peak demands. Therefore it is necessary that industry

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49 *White Paper*, p

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

51 Dr Richard Deniss, Executive Director, Australia Institute, *Proof Committee Hansard*, 25 March 2009, p, 74.

52 Mr Tony Westmore, Australian Council of Social Service, *Proof Committee Hansard*, 23 March 2009, p 25.

assistance is provided to ensure energy security whilst the renewable energy sector develops.

Climate Change Action Fund

6.56 The Fund will receive $2.2 billion over five years which will be deployed to smooth the transition. Among activities to be supported from the Fund are informing people about the operation of the Scheme, assisting small businesses and community organisations invest in more energy efficient equipment, competitive grants for low emission technologies, structural adjustment for workers and communities adversely affected by the Scheme and special assistance to gassy coal mines.

6.57 A stakeholder Consultative Committee will be formed in 2009 to advise on the design of the Fund.

6.58 Some witnesses thought the fund would play an important role:

> …if used wisely, the Climate Change Action Fund may be as important as the carbon price…[it should be increased and used] to deliver an additional range of business engagement and emission reduction programmes.[53]

> Support for our workers, communities and regions will also be vital and that the full weight of the Climate Change Action Fund be devoted to this end. The CCAF may need to be supplemented if necessary (beyond $200 million) to ensure adequate coverage in the context of the transition during the GFC and to share the benefits of new infrastructure investment and industry assistance measures.[54]

6.59 It may be too soon to be definitive about its operations:

> the details of the…climate change action fund are not there.[55]

> The precise details of that scheme have not been finalised; there are consultations going on.[56]

6.60 There were various suggestions made about priorities for the fund. The Australian Geothermal Energy Association suggested some modest allocations to help renewable energy companies demonstrate their commercial viability by building pilot plants.[57] The Energy Users Association of Australia thought it could fund measures to

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53 Ms Anna Reynolds, Energetics, *Proof Committee Hansard*, 25 March 2009, p 39.

54 Australian Workers' Union, *Submission 27*, p 9.

55 Mr Peter Burns, Australian Industry Group, *Proof Committee Hansard*, 27 March 2009, p 84.

56 Mr Blair Comley, Acting Secretary, Department of Climate Change, *Proof Committee Hansard*, 30 March 2009, p 6.

57 Ms Sue Jeanes, Chief Executive, Australian Geothermal Energy Association, *Proof Committee Hansard*, 25 March 2009, p 39.

encourage energy efficiency.[58] The Australasian Railway Association called for targeted rail investment and programmes to inform transport choices.[59]

The impact on, and assistance for, households and small business

6.61 About half the revenue raised from selling permits will be dedicated to assisting households.

6.62 Assistance measures for households will be initially based on an assumed carbon price of $25 a tonne. This will increase the average household's electricity bill by around $4-5 per week and gas and other household fuel bill by $2 per week (assuming no behavioural response).[60]

6.63 The total impact on the CPI is estimated at 1.1 per cent in 2010-11.[61] This is also the average increase in prices facing the average household. The impact will vary across households depending on their expenditure patterns, from 1.4 per cent for the average low-income sole parent or pensioner household to 0.9 per cent for the average high-income single income childless household.[62]

6.64 This is an upper bound for the impact on household budgets, as consumers 'shift household consumption towards goods that become relatively cheaper because they require fewer emissions to produce'.[63]

6.65 Benefit recipients will automatically receive assistance for these price increases as the benefits are indexed. Indeed, given the possibility of substituting away from the products that have become dearer, they will be overcompensated by the indexation arrangements.

6.66 In addition, the Government's plan involves additional payments to pensioners, seniors, carers and people with disabilities of around 1½ per cent. There will also be additional support to low- and middle-income households, through increases in the low income tax offset, family tax benefits and dependency tax offsets and a transitional payment of $500 for some low-income singles.

6.67 Assistance to households is premised on the notion that, while most households will be able to adjust their behaviour to minimise the impact of the scheme on their standard of living, those who have a low capacity to absorb or avoid the

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58 EUAA, *Submission 74*, p 14.

59 Australasian Railway Association, *Submission 73*, p 2.

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

61 *White Paper*, p 17-2. Treasury (2008, p xv) refers to 'a one-off rise in the price level of around 1-1.5 per cent'. The Reserve Bank refers to a 'total effect of around 1 per cent'; *Statement on Monetary Policy*, February 2009, p 68. See also the discussion of impact on inflation below.

62 *White Paper*, p 17-2.

63 *White Paper*, p 17-1.

effects of the scheme should be provided with direct assistance.[64] The proposed assistance comprises:

- pensioners, seniors, carers and people with disability will receive additional support, above indexation, to fully meet the expected overall increase in the cost of living flowing from the scheme;
- other low–income households will receive additional support, above indexation, to fully meet the expected overall increase in the cost of living flowing from the scheme;
- around 89 per cent of low-income households (or 2.9 million households) will receive assistance equal to 120 per cent or more of their cost of living increase;
- middle–income households will receive additional support, above indexation, to help meet the expected overall increase in the cost of living flowing from the scheme. For middle–income families receiving Family Tax Benefit Part A, the Government will provide assistance to meet at least half of those costs;
- around 97 per cent of middle-income households will receive some direct cash assistance. Around 60 per cent of all middle-income households (or 2.4 million households) will receive sufficient assistance to meet the overall expected cost of living increase; and
- motorists will be protected from higher fuel costs from the scheme by ‘cent for cent' reductions in fuel tax for the first three years.[65]

6.68 Additional household assistance is provided not only to ensure that those who can least afford the cost of living increase are not disadvantaged but also to ensure additional support through the introduction of energy efficiency measures and consumer information to help households take practical action to reduce energy use and save on energy bills.[66] This should enable households, particularly those that also modify their behaviour, to pay for energy saving appliances and equipment.

6.69 Furthermore, the Government will bring forward the indexation around the time of the CPRS' introduction so that the additional payments are available to meet additional energy costs at the time the scheme commences.

6.70 The Australian Council of Social Service is guardedly satisfied with the proposed assistance:

> … whether or not the compensation proposed is sufficient. We are concerned that it may not be but we are relying on Treasury modelling. Other modelling suggests that the flow-through to cost of living will be

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

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

66 Department of Climate Change, http://www.climatechange.gov.au/greenpaper/factsheets/pubs/fs7.pdf

> higher than 1.1 per cent, particularly for certain kinds of households, notably single pensioners and sole parents. But we are going with the Treasury modelling and with the promise of reviews and indexation subsequently.[67]

Committee comment

6.71 The Committee believes the assistance programme for low income households strikes the right balance between ensuring they are not disadvantaged but retaining incentives to lower greenhouse gas emissions. Furthermore, additional assistance than what is required will support households to invest in energy efficient measures for their homes.

Transitional fuel tax offset

6.72 The impact of the CPRS on petrol prices will be offset by cuts in other fuel taxes.

6.73 A transitional offset is not the same as temporarily excluding transport emissions from the scheme, for a number of reasons. First, coverage should still provide a signal to motorists that carbon prices will affect their long-term transport decisions.

6.74 Second, scheme coverage means that fuel suppliers will be required to participate fully in the scheme, including establishing the administrative mechanisms required to determine and allocate liabilities for liquid fuels.

6.75 Further, coverage ensures that transport emissions are included within the scheme cap. If transport emissions grow, more abatement will be required in other sectors of the economy.

6.76 As a higher fuel price leads people to buy more fuel-efficient models when they replace cars, and prefer to live nearer to public transport, the long-run response to an increase in fuel prices is much more than the short-term response.

> We find price elasticities of -0.13 (short term) and -0.20 (long term).[68]

> The short-term elasticity is usually considered as about negative 0.1, and the long-term elasticity is more in the realm of minus 0.3 to minus 0.5... [69]

> The green paper last year by the Bureau of Infrastructure, Transport and Regional Economics… seemed to indicate that short-run elasticity is around

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67 Mr Tony Westmore, ACOSS, *Proof Committee Hansard*, 23 March 2009, p 23.

68 Dr Robert Breunig and Carol Gisz, 'An exploration of Australian petrol demand: unobservable habits, irreversibility and some updated estimates', *Economic Record*, vol 85, no 268, March, pp 73-91.

69 Mr Michael Roth, Royal Automobile Club of Queensland, *Select Committee on Fuel and Energy*, *Committee Hansard*, 20 February 2009, pp 3-4.

> 0.1 to 0.2 and long-run elasticity—perhaps five to 10 years out—is around about 0.4 to 0.5.[70]

Committee comment

6.77 The Committee regards carbon leakage and the need to smooth the adjustment process to a low-carbon economy as good reason for some government assistance to industry. It is also important that low income households are not unduly disadvantaged. The CPRS structures these assistance measures in a manner that retains incentives to take measures to reduce emissions of greenhouse gases.

6.78 The committee notes the persistent advocacy of industry groups for further assistance under the scheme. On the other hand other stakeholders have criticised the scheme for being too generous to polluting industries.

6.79 The committee believes that the Bill has the balance right, retaining strong incentives to reduce carbon intensity while enabling important economic assets to remain viable throughout the adjustment. This is fundamentally important to protecting jobs and enabling jobs in the green economy to grow.

70 Mr Topham, Caltex, *Select Committee on Fuel and Energy*, *Committee Hansard*, 20 February 2009, p 56.