AUSTRALIAN FOOD AND GROCERY COUNCIL

SUBMISSION

SUBMISSION TO INQUIRY INTO EXPOSURE DRAFT OF THE LEGISLATION TO IMPLEMENT THE CPRS

25 March 2009

PREFACE

The Australian Food and Grocery Council is the peak national organisation representing Australia's food, drink and grocery manufacturing industry.

The membership of the AFGC comprises more than 150 companies, subsidiaries and associates which constitutes in the order of 80 per cent of the gross dollar value of the highly processed food, beverage and grocery products sectors. (A list of members is included as Appendix A.) The AFGC represents the nation's largest manufacturing sector. By any measure our members are substantial contributors to the economic and social welfare of all Australians. Effectively, the products of AFGC's member companies reach every Australian household.

The industry has annual sales and service income in excess of $70 billion and employs more than 200 000 people – almost one in five of the nation's manufacturing workforce. Of all Australians working in the industry, half are based in rural and regional Australia, and the food manufacturing sector sources more than 90 per cent of its ingredients from Australian agriculture.

The AFGC's agenda for business growth centres on public and industry policy for a socioeconomic environment conducive to international competitiveness, investment, innovation, employment growth and profitability.

The AFGC's mandate in representing member companies is to ensure a cohesive and credible voice for the industry, to advance policies and manage issues relevant to the industry enabling member companies to grow their businesses in a socially responsible manner.

The Council advocates business matters, public policy and consumer-related issues on behalf of a dynamic and rapidly changing industry operating in an increasing globalised economy. As global economic and trade developments continue to test the competitiveness of Australian industry, transnational businesses are under increasing pressure to justify Australia as a strategic location for corporate production, irrespective of whether they are Australian or foreign owned. In an increasingly globalised economy, the ability of companies to internationalise their operations is as significant as their ability to trade globally.

Increased trade, rationalisation and consolidation of businesses, increased concentration of ownership among both manufacturers and retailers, intensified competition and dynamic, increasingly complex and demanding consumers are features of the industry across the globe. Moreover, the growing global middle class of consumers is more sophisticated and discerning, driving innovation and differentiation of products and services.

The AFGC is working with governments in taking a proactive approach to public policy to enable businesses to tackle the threats and grasp the dual opportunities of globalisation and changing consumer demands.

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1 Opening Statement

The Australian Food and Grocery Council (AFGC) welcomes the opportunity to make a submission to the Senate Standing Committee on Economics inquiry into the exposure draft of the legislation to implement the Carbon Pollution Reduction Scheme.

While the AFGC has not directly assessed the fundamental science which supports climate change as a result of global warming, the impact it may have on the environment and agricultural production systems or the overall impact on the Australian economy, we support and agree with the objective of reducing carbon emissions across the economy.

While we support the objective, the AFGC seeks to find solutions that allows the sector to remain profitable. This can be done by facilitating a shift in the way the economy sources and uses energy so that carbon emissions are reduced but ensuring that there is sufficient capacity in the economy to maintain global competitiveness.

The issue of reducing emissions is pressing and we agree that action needs to be taken in the short term. However, while we support the objective we are of the view that changes of the type that are being proposed can only be made by sectors that remain profitable. In addition the AFGC considers that if a policy of this magnitude is going to be implemented then it must be done right. Delays of one or two years should be considered with the critical objective of achieving the right outcome with the right policy mechanism. The objective should be to facilitate a shift in the way the economy sources and uses energy so that carbon emissions are reduced but ensuring that there is sufficient capacity in the economy to maintain global competitiveness.

The key issue for the AFGC is not a question of whether Australia should become more energy efficient and therefore reduce emissions, but by how much, by what means and at what cost to the economy. The accumulation of greenhouse gas emissions is a global problem. In the absence of a global approach, any domestic emissions trading scheme that imposes costs will make trade exposed domestic industry less globally competitive, and may well contribute to the relocation of the manufacturing base offshore, taking the emissions with it; but with no net environmental benefit. Notwithstanding the success of the food and grocery industry, it is facing significant challenges threatening its competitiveness and profitability *viz*: the real impacts of climate change; volatile input costs (energy, transport and raw materials); which have real threats to Australia as a manufacturing base.

2 Executive Summary

The AFGC recognises the need to reduce carbon emissions and for industry to become more energy efficient. In addition however the AFGC also recognises that with some fundamental shifts in the economy foreshadowed by the policy debate, industries such as the food, beverage and grocery will be severely impacted.

The AFGC has significant concerns about the pace at which the proposed approach is being progressed. The legislation that will provide for the CPRS was released on 10 March 2009 comprising six draft Bills with comments being required just ten days later to the Senate Standing Committee on Economics that is tasked with inquiring into the impact of the proposal and the associated legislation. In addition as part of the formal consultation process the government has allowed slightly more than one month for industry and the community to comment on the legislation that will change the economy of Australia.

The AFGC remains significantly concerned about the potential negative impacts the current proposed CPRS will have on the food, beverage and grocery manufacturing sector. It is the AFGC view that the current modelling has not provided sufficient consideration as to the impacts of the CPRS on the manufacturing sector. More specifically it does not take into account the impact of the policy on the largest sector within manufacturing, the food, beverage and grocery sector. The food and grocery sector operates on extremely small margins in what is an ever expanding global market. The Australian food and grocery market is trade exposed and value chains source from the cheapest destination to maintain viability. In the absence of a similar cost in other countries, the ability of Australian food and grocery companies to competitively supply both the domestic and exports markets and continue to employee Australian workers will be diminished. If the current flawed policy approach is implemented it will simply mean exporting jobs and emissions offshore while doing very little to reduce environmental impact.

Given the absence of a global price or market for carbon the government proposal has not has not given sufficient consideration to the use of a consumption based model for carbon emissions. Such as system would allow the domestic industry to maintain competitiveness on like terms with countries that produce like goods in without the additional cost.

3 EXPOSURE DRAFT OF THE LEGISLATION TO IMPLEMENT THE CPRS

While it is encouraging that the Senate Economics Committee has been given the opportunity to review the draft Bills it is nonetheless disappointing that the Committee will report before the economic implications are able to be properly assessed by the Australian community. In addition it is also staggering that industry and the community has been provided with such a short time frame (10 working days) to review what is generally agreed to represent one of the most significant reforms to the economy ever attempted. While marginally better, the timeframe the government has allowed to provide comment on the draft legislation (30 days) is also not adequate given the magnitude of the intended policy changes and the size of the draft legislation that will provide for it.

Accordingly, the AFGC suggests that the economic implications of the CPRS legislation cannot be satisfactorily assessed at this time for two key reasons. First, most of the key elements that will determine the economic impacts are not included 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 have indicated their possible commitment. 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 food and grocery sector varies across the sector in terms of its energy intensity. There is no doubt however that both the domestic and global market for food and grocery items is extremely competitive and cost increases can have significant impacts on viability. The draft Bills devote just six pages to this vital element of design and provide little in terms of substance. The AFGC understands that all of the details that will determine the impacts on trade-exposed industry will not be brought before Parliament until the first quarter of 2010, just three months before the scheme is scheduled to commence;

- 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 pass through 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 R&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; and

- Industry notes that the modelling so far released by the Treasury provides very little insight into the likely economic impacts on Australia particularly on everyday consumables. There is still a level of ambiguity in terms of specific details of the proposal such as controlling operations and operational control. 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.

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 result in a poor environmental outcome.

In the two weeks since the draft Bills have been released, business has been attempting to come to grips with what is, and what is not, included in the Bills. In the next few weeks, and before submissions are required by the Government on 14 April 2009, industry leaders will attend information sessions and workshops being conducted by the Department of Climate Change, the Treasury, and various consulting firms.

As a consequence, AFGC is not in a position to give the Committee a considered submission addressing the detailed provisions of the draft Bills.

If flaws in the current proposal are to be avoided, and in the context of a limited global agreement, then the CPRS legislation will need to:

- 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
    - 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 a sensible 'safety valve' price trajectory to 2020 that caps the economic impact on the community. This price trajectory could be abolished once the domestic and international emissions markets has matured and stabilised.
- 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.
- Not restrict the import of emission reduction 'credits' that could lower the price of permits in Australia.
- Fully offset the loss of trade competitiveness of industry. The Australian Industry Greenhouse Network (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 White Paper should:
    - 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)
    - review the policy approach and investigate a consumption-based approach (as proposed by Geoff Carmody).
- Provide for the abolition or phasing out of competing or 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.

4 NEED TO REVIEW THE POLICY

The AFGC supports the following principles of an emissions reduction scheme:

1) Climate change is best tackled from a position of profitability and global competitiveness.

2) The impact of the global financial crisis on the economy should be taken into account when assessing the capacity of the Australian economy to implement an emissions trading scheme in 2010.

3) There is no Australian solution to climate change, there is only a global solution.

4) Any emissions trading scheme must not result in the export of emissions and jobs.

5) Excessive haste carries great risk (to the resilience of our economy).

The AFGC has significant concern relating to the potential negative impacts the proposed CPRS will have on the food, beverage and grocery manufacturing sector. The sector operates on extremely small margins and any additional costs are likely to be passed directly onto the consumer. Any response to climate change can only happen if the industry remains profitable. **The current modelling has not considered sufficiently the impacts of the CPRS on FMCG sector and its products.**

Obligations imposed up and downstream of the farm gate mean that carbon costs will be passed through the food supply chain to consumers. This will undoubtedly result in higher food, beverage and grocery prices. This issue has not been adequately addressed to date and the AFGC recommends Government conduct specific modelling of the impact on the prices of food and grocery products from the CPRS taking into account the capacity of the supply chain to absorb additional costs. The additional impost to the community in terms of increased expenditure on house hold items and food has not been adequately addressed. The government White Paper suggests cost will increase by approximately 1% based on household energy consumption for heating cooling etc. It does not take into consideration the flow of costs through the supply chain where increased prices will be incurred at every stage and ultimately born by the consumer on everyday essential items like bread, milk and sugar. The government White Paper suggests households will incur an average increase in spending of $6 per week on household fuels but provides little detail on the increase in spending on community staples such as food and beverage. This is of some concern as Australian Bureau of Statistics figures indicate food and beverage spend represents approximately 20% of the average weekly spend where as energy represents only approximately 3% of household expenditure.

Global companies, which can take advantage of lowest cost locations, supply and distribution chains to ensure they remain competitive, are likely to move offshore and continue to produce emissions resulting in a negative impact both environmentally and economically. In the absence of similar schemes overseas the introduction of a CPRS creates an uneven playing field for Australian businesses and particularly those that compete with imports of similar goods. The Australian market has access to cheap and reliable energy supply which to some extent offsets the nation's high labour costs and remote geographical location compared to other manufacturing regions of the world. This comparative advantage will be eroded if Australia acts in isolation or more aggressively with economic means to reduce carbon emissions.

Decision-making for investment decisions within the food, beverage and grocery manufacturing sector does not always reside in Australia. There are a range of multinational organisations that have businesses located in Australia. They can and do source product within the global market place and are constantly reviewing operations located in Australia to ensure they remain competitive and viable. Investment decisions multinational organisations are often characterised by internal as well as external competition for capital.

AFGC is of the view Australia's emission targets should be at a level that is commensurate with "advanced economies taking on reductions comparable to Australia". However, both the -5% and the -15% targets the Government intends committing Australia to, 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. Further, Treasury modelling estimates that these targets mean that Australians could incur wealth losses 3 to 4 times higher than the losses that Europeans and Americans bear by 2020.

The ambitious time frame for the establishment of the emission trading scheme has required the fast track development of a number of key design aspects of the proposed arrangements. The AFGC would be supportive of a review of the proposed timeframe to ensure the policy can be implemented in a way that does not have unintended consequences but provides for a long term approach to the critical issue of global warming.

The proposed policy and associated legislation does not offset the competitive disadvantage of trade-exposed businesses, and losses of jobs and investment particularly in the manufacturing sector will be inevitable for minimal environmental gain (as goods will be sourced from countries that do not have a cost of carbon and are not required to reduce emissions). 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 White Paper asserts that just 25% of permits will be sufficient to ensure no loss of competitiveness, investment and jobs from these businesses. Industry[i] estimates, assuming a historical growth rate in trade-exposed industries of 1.5% per annum excluding agriculture, 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 White Paper.

4.1 NEED FOR PARITY FOR TRADE EXPOSED INDUSTRIES – THE URGENT NEED TO CONSIDER A 'CONSUMPTION' BASED APPROACH.

The accumulation of greenhouse emissions is a global problem. In the absence of a global approach, any domestic emissions trading scheme that imposes costs will make domestic companies less globally competitive, and may well contribute to the relocation of the manufacturing base offshore, taking the emissions with it; but with no net environmental benefit. The potential for the cost impact of CPRS to erode the food, beverage and grocery industry's comparative advantage based around cheap energy, high quality inputs and available land should not be underestimated.

The AFGC supports development of carbon reduction mechanisms that do not un-necessarily compromise the international competitiveness of the largest manufacturing sector in the Australian economy without having any environmental benefit.
Given the absence of a global price or market for carbon there has not been sufficient consideration of the use of a consumption based model for carbon emissions. Such a system would allow the domestic industry to compete on like terms with the increasing level of imported food products. In addition it would have the significant benefit of reducing emissions without having the negative impact of driving manufacturing jobs and investment offshore to countries that do not have a similar cost impost placed on business. A consumption, rather than a production, based model is trade competitiveness neutral. Imports could be priced at a relative level to domestically produced goods. National concerns about carbon leakage and job losses are minimised as there is a level of equity for Australian industry[ii].

In the absence of a global approach, any domestic emissions trading scheme should provide a level playing field for impacted industries such as the food and grocery sector, until a binding international deal is brokered. This will ensure that any mechanism does not un-necessarily compromise the international competitiveness of the largest manufacturing sector in the economy without having any environmental benefit.

The AFGC has noted the public debate on the features of both production-based and consumption-based models for addressing the climate issue. The claims for the consumption based model (see box) address many of the short comings of the production-based model which will need to be addressed by industry specific adjustments or carve-outs, which ultimately may serve to undermine the effectiveness of reducing carbon emissions.

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[i] Australian Industry Greenhouse Network.

[ii] Effective Climate Change Policy: The Seven C's Geoff Carmody and Associates October 2008.

The AFGC will continue to examine all policy options for addressing climate change and will work with Government to secure the best outcome not only for the Australian food and grocery sector, but also for Australia as a whole as the AFGC considers them to be inextricably linked. The AFCG will continue, therefore, to test policy options against the yardsticks of affordability, competitive neutrality, equity and capability to deliver overall net carbon emission reductions.

Extract from Australian Financial Review 15 January 2009. *Consumption model the practical way to go for all.* Geoff Carmody.

"The emission consumption model is practical. It starts with the production information required under the green/white papers. It uses Australia's existing tax invoice system to pass carbon cost signals transparently down the supply chain to consumers, zero-rates exports (which then have carbon prices imposed by importers), and imposes a trade competitiveness-neutral border tax adjustment on competing imports. This ensures trade-neutrality and is World Trade Organisation compliant. There are no job losses overseas, and Australia's own emission reductions make the same net contribution to global emissions reductions. All countries should adopt this model".

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