Chapter 3

The Proposed Carbon Pollution Reduction Scheme

Introduction

3.1 This chapter outlines the Carbon Pollution Reduction Scheme (CPRS) including the major differences between the *Carbon Pollution Reduction Scheme: Green Paper* (the Green Paper) and the *Carbon Pollution Reduction Scheme: Australia's Low Pollution Future – White Paper* (the White Paper). The committee received extensive feedback regarding the limitations of the proposed CPRS. Chapter 3 will explore the issues raised including the questionable environmental benefits of the scheme in terms of reducing global emissions, the proposed timing of the implementation of the scheme, and the lack of recognition of individual action.

What is the CPRS?

3.2 The government has stated that the CPRS is the 'centrepiece of Australia's domestic emissions reduction strategy.'[1] It is a cap and trade based emissions trading scheme.

The Green Paper

3.3 The Green Paper was essentially a consultation document which set out the government's initial proposed approach for the establishment of an Australian emissions trading scheme (ETS), and presented options and preferred approaches to various issues.[2]

3.4 The government stated that the Green Paper was informed by consultations undertaken from March to June 2008, by the *Garnaut Climate Change Review: Final Report* and the work of the Task Group on Emissions Trading and the National Emissions Trading Taskforce.[3]

3.5 The Green Paper was released on 16 July 2008. This was followed by consultation from July to September 2008.

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1 Australian Government, *Carbon Pollution Reduction Scheme: Australia's Low Pollution Future – White Paper (White Paper)*, December 2008, p. 1.9.

2 Australian Government, *Carbon Pollution Reduction Scheme: Green Paper (Green Paper)*, July 2008, p. 9.

3 Australian Government, *Green Paper*, July 2008, p. 11.

Key content

3.6 The Green Paper outlined a cap and trade approach to an ETS, under which a cap is set, and the government issues carbon pollution permits equal to that cap. Emitters must obtain permits, monitor their emissions, and at the end of each year, must provide a permit for each tonne of emissions they produced in that year.[4]

3.7 The scheme proposed very broad coverage, including all six greenhouse gases listed under the Kyoto Protocol: carbon dioxide, methane, nitrous oxide, sulphur hexafluoride, hydrofluorocarbons and perfluorocarbons.[5]

3.8 The Green Paper proposed coverage of 75 per cent of Australia's emissions including the following sectors: stationary energy, transport, industrial processes, waste, and fugitive emissions. Forestry would be included from commencement on a voluntary 'opt-in' basis, while agriculture would not be covered until 2015. Obligations would apply to facilities which directly emit 25 000 tonnes of carbon dioxide equivalent per year or more.[6]

3.9 The Green Paper noted that the proposed scheme would be designed to link with schemes developed overseas.[7]

3.10 The Green Paper proposed to use the *National Greenhouse and Energy Reporting Act 2007*, introduced by the previous government, as the basis for a single national emissions reporting framework and the establishment of an independent scheme regulator. The regulator would have the role of monitoring and enforcing compliance, running permit auctions, allocating free permits and maintaining the national emissions registry.[8]

3.11 The Green Paper also provided for assistance to households, business, regions, workers, emissions-intensive trade-exposed industries and strongly affected industries.[9]

Issues raised

3.12 A number of issues relating to the scheme as proposed in the Green Paper were raised with the committee. The overwhelming majority of these were to do with the definition of emissions intensive trade exposed (EITE) industries and strongly

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4 Australian Government, *Green Paper*, July 2008, p. 12.

5 Australian Government, *3. Scheme Coverage*, Fact Sheet, July 2008, available at http://www.climatechange.gov.au/greenpaper/factsheets/index.html (accessed 21 April 2009).

6 Australian Government, *3. Scheme Coverage*, Fact Sheet, July 2008, available at http://www.climatechange.gov.au/greenpaper/factsheets/index.html (accessed 21 April 2009).

7 Australian Government, *Green Paper*, July 2008, pp 23-24.

8 Australian Government, *Green Paper*, July 2008, pp 23 and 31.

9 Australian Government, *Green Paper*, July 2008, pp 24-31.

affected industries, and the assistance afforded to them under the Green Paper. These are discussed in chapter 5. To an extent, some of the concerns raised with the committee were addressed by the White Paper, as explained below.

The White Paper

3.13 On 15 December 2008, the White Paper was released, setting out the government's decisions on the design and operation of the CPRS.[10]

3.14 This section sets out the aspects of the White Paper on which the committee received evidence. The concerns expressed to the committee about the White Paper then follow.

Key content

3.15 The White Paper largely retained the same main elements of the scheme as outlined in the Green Paper, but provided further detail or clarification on various aspects.

3.16 The White Paper articulated the government's medium term emissions reduction target as follows:

> The target range for emissions reductions to be achieved by 2020 will be from 5 per cent to 15 per cent below 2000 levels.
>
> The range represents:
>
> - a minimum (unconditional) commitment to reduce emissions to 5 per cent below 2000 levels by 2020 (projected to be a 27 per cent reduction in per capita terms)
> - a commitment to reduce emissions by up to 15 per cent below 2000 levels by 2020 (projected to be a 34 per cent reduction in per capita terms) in the context of global agreement under which all major economies commit to substantially restrain emissions and advanced economies take on reductions comparable to Australia.
>
> The Government recognises that ambitious global action is in Australia's national interest.
>
> In the event that a comprehensive global agreement were to emerge over time, involving emissions commitments by both developed and developing countries that are consistent with long-term stabilisation of atmospheric concentrations of greenhouse gases at 450 ppm CO2-e or lower, Australia is prepared to establish its post-2020 targets so as to ensure it plays its full role in achieving the agreed goal.[11]

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10 Parliamentary Library, *Carbon Pollution Reduction Scheme*, Climate Change Web Publication, http://www.aph.gov.au/library/pubs/ClimateChange/governance/domestic/national/cprs.htm (accessed 15 April 2009).

11 Australian Government, *White Paper*, December 2008, p. 4.17.

3.17 An indicative national emissions trajectory was also outlined in the White Paper:

> The national emissions trajectory represents the national emissions reduction commitment over the period covered by the trajectory as a whole. It is not a projection of expected actual emissions for that period.[12]
>
> …
>
> The first indicative national emissions trajectory will be:
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> - in 2010–11, 109 per cent of 2000 levels
> - in 2011–12, 108 per cent of 2000 levels
> - in 2012–13, 107 per cent of 2000 levels.[13]

3.18 The government confirmed scheme caps and gateways in the White Paper as follows:

> The Government will specify Scheme caps for at least five years in advance. In addition, up to a further 10 years of guidance will be provided through the establishment of 'gateways' or ranges within which future Scheme caps will lie. To maintain five years' guidance, Scheme caps will be extended by one year, every year. Gateways will be extended for five years, every five years.
>
> The first five years of Scheme caps will be announced in 2010, before the Scheme commences and after the Copenhagen meeting of the Parties to the United Nations Framework Convention on Climate Change (UNFCCC) and the Kyoto Protocol.[14]

3.19 The White Paper noted that, in terms of the auctioning of permits:

> Allocations will, over the longer term, progressively move towards 100 per cent auctioning as the Scheme matures, subject to the provision of transitional assistance for emissions-intensive trade-exposed industries and strongly affected industries.[15]

3.20 The government provided for the international trade of permits in the White Paper:

> The use of eligible international units for compliance in the Scheme will not be subject to any quantitative limitations.[16]

3.21 In respect of large electricity users, the White Paper stated:

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12 Australian Government, *White Paper*, December 2008, p. 4.20.

13 Australian Government, *White Paper*, December 2008, p. 4.23.

14 Australian Government, *White Paper*, December 2008, p. xxxi.

15 Australian Government, *White Paper*, December 2008, p. lxvi.

16 Australian Government, *White Paper*, December 2008, p. lxix.

> For large electricity users that consume more than 2000 gigawatt-hours a year at a single facility, contractual arrangements will be considered by the regulator to determine an entity-specific electricity allocation factor if those contracts were entered into before 3 June 2007 and remain in force on 1 January 2010.[17]

3.22 Some issues regarding legacy emissions from landfill sites were covered in the White Paper:

> Emissions from landfill waste sites that closed prior to 30 June 2008 will not be included in the scheme. Emissions from waste deposited prior to 1 January 2009 will be excluded from the Scheme until 2018.[18]

3.23 Following a number of concerns raised regarding the EITE assistance, various aspects of the eligibility assessment and the quantum of the assistance provided for were altered. The government released the following table summarising the changes to the EITE assistance:

Table 3.1 Summary of EITE Assistance Changes

Issue	White Paper position	Green Paper position
Extension of assistance to activities at a lower level of emissions-intensity	The threshold for the 60 per cent rate of assistance has been lowered to apply to activities with an emissions-intensity between 1000 and 1999 t CO_2-e per million dollars of revenue or 3000 and 5999 t CO_2-e per million dollars of value-added.	The threshold for the 60 per cent rate of assistance was to apply to activities with an emissions-intensity between about 1500 and 2000 t CO_2-e per million dollars of revenue.
Metric for assessing emissions intensity	Emissions intensity, for the purposes of determining eligibility of an activity for receiving assistance under the EITE assistance program, will be assessed on either: • the weighted average emissions per million dollars of revenue generated by entities conducting the activity; or • the weighted average emissions per million dollars of value added generated by entities conducting the activity. Where an entity requests that the Government use this metric, the entity and Government will need to agree on which input costs will be adjusted to calculate a proxy for value added for the activity.	Relative carbon cost exposures of different activities assessed using emissions per million dollars of revenue.

17 Australian Government, *White Paper*, December 2008, p. 12.73.

18 Australian Government, *White Paper*, December 2008, p. B.5.

Emissions associated with the production of natural gas used as feedstock	Assessment of the eligibility of activities and the determination of the baseline allocations will include the cost increases related to the upstream emissions associated with the production of natural gas and its components when they are used as a feedstock.	No assistance should be provided for any upstream emissions costs other than those associated with electricity.
Period of assessment	Emissions-intensity will be assessed on estimates of revenue or value-added per unit of production in the period from 2004-05 to the first half of 2008-09.	Data from 2006-07 to 2007-08 used to assess eligibility.
Trade exposure test	Trade exposure of an activity will be assessed on either its trade share being greater than 10 per cent in any year since 2004-05 or a demonstrated lack of capacity to pass through costs due to the potential for international competition.	Any activity for which there was no physical barrier to trade would be considered for EITE assistance.
Carbon productivity contribution	Initial rates of assistance (90 or 60 per cent) accorded each EITE activity will be reduced by the carbon productivity contribution of 1.3 per cent per annum to ensure that EITE activities share in the national improvement in carbon productivity.	Rates of assistance to be reduced over time with the intent that the share of assistance to the EITE sector would not increase significantly over time.
Quantum of assistance	EITE industries will be allocated around 25 per cent of total carbon permits at the start of the Scheme (equivalent to around 35 per cent if agricultural emissions were included in the Scheme). Depending on growth in EITE industries and future global developments, EITE assistance could reach to around 45 per cent of permits by 2020. Eligibility thresholds or initial rates of assistance will not be readjusted or recalibrated in light of any subsequent information about the quantum of assistance likely to be provided as EITE assistance.	Up to around 30 per cent of total available permits to be allocated to entities conducting EITE activities, taking into account the likely allocation to EITE agriculture industries from any eventual inclusion of agricultural emissions in the Scheme.

Review of the EITE assistance program	The EITE assistance program will be reviewed every 5 years or at another date at the request of the Minister for Climate Change and Water in relation to: • whether additional activities should be considered for EITE assistance on account of changes in commodity prices or Scheme coverage • whether modifications should be made to the EITE assistance program on the basis of whether it continues to be consistent with the rationale for assistance, is conferring windfall gains on entities conducting activities and is appropriately balancing the competing policy objectives • whether assistance should be withdrawn because broadly comparable carbon constraints are applying internationally, at either an industry or economy-wide level, or an international agreement involving Australia and all major emitting economies is concluded.	Five year EITE review to examine similar issues though the Government did not canvass the inclusion of additional activities.

Australian Government, *EITE Assistance Program: Changes from the Green Paper Position*, Fact Sheet, December 2008.

Issues raised

3.24 The majority of evidence the committee received about the changes to the scheme as set out in the White Paper noted that while the White Paper contained some improvements from the Green Paper, particularly in regard to EITE industries, significant further changes were necessary to protect Australia's trade exposed industries and prevent carbon leakage.

3.25 The Australian Industry Greenhouse Network (AIGN) noted:

> The White Paper proposes an improved program of permit allocations emission intensive trade-exposed industry and Climate Change Action Fund (CCAF) grants for other industry. The proposed program, however, does not offset the competitive disadvantage of trade-exposed businesses, and losses of jobs and investment will be inevitable for minimal environmental gain.[19]

3.26 The AIGN further commented:

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

19 Australian Industry Greenhouse Network (AIGN), answer to written question on notice, 14 January 2009 (received 23 January 2009).

> losses around $10 billion at a permit price of $25/tCO2. A fairer outcome is needed.[20]

3.27 The Australian Aluminium Council (AAC) 'recognises that the proposed decay rate of 1.3 per cent is an improvement over options proposed in the Green Paper…' but argues that assistance should not be reduced over time if international competitors are not subject to comparative carbon costs.[21]

3.28 The AAC further noted the recognition of large electricity users in the White Paper, but commented that 'This is appropriate for existing contracts but is a threat to the viability of large users at the time of contract renewal.'[22]

3.29 While organisations noted that under the White Paper the liquid natural gas (LNG) sector would be eligible for assistance, the DomGas Alliance drew attention to the fact that domestic natural gas production does not qualify for assistance, and the effects of this could be significant:

> To the extent that the gas supplier is not able to pass onto its customers the carbon costs incurred at every step in the gas supply chain, this will distort investment decisions in favour of LNG over domestic gas. Where gas producers are able to pass on carbon costs to the domestic market, this will further increase the cost of natural gas for downstream industry.
>
> The CPRS could cause serious domestic gas shortages, result in higher gas and electricity prices, lead to investment distortion, and undermine Australia's energy security.[23]

3.30 Qantas noted their concern that aviation still does not qualify for transitional assistance under the CPRS, even though it is clearly energy intensive and trade exposed.[24]

3.31 The South West Group welcomed the White Paper's proposed treatment of legacy emissions from the waste sector. However, the group noted that no financial assistance had been provided for local governments under the scheme as proposed, and that the treatment of landfill facilities in close proximity to each other creates an administrative burden for local government.[25]

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20 AIGN, answer to written question on notice, 14 January 2009 (received 23 January 2009).

21 Australian Aluminium Council (AAC), answer to written question on notice, 14 January 2009 (received 28 January 2009).

22 AAC, answer to written question on notice, 14 January 2009 (received 28 January 2009).

23 DomGas Alliance, answer to written question on notice, 14 January 2009 (received 23 January 2009).

24 Qantas, answer to written question on notice, 14 January 2009 (received 13 February 2009).

25 South West Group, answer to written question on notice, 14 January 2009 (received 21 January 2009).

3.32 The committee has also received evidence from the Mackay Regional Council, Gladstone Regional Council and the Wollongong Council that the costs associated with purchasing permits for landfill sites will have a significant impact on local government and will likely lead to the councils imposing increased charges.[26] Representatives of the Mackay Regional Council stated that the additional cost:

> …could be an additional $5 million a year in total in relation to carbon permits for this council.
>
> …
>
> Basically, we are talking about there being rate rises. That is effectively the only method we think would be able to fund those things.[27]

3.33 The Energy Supply Association of Australia also noted that the scheme caps and gateways provided for in the White Paper are insufficient and will not provide investment certainty:

> However, the White Paper's proposal to only commit to five years of firm Scheme caps is disappointing…the proposed timeframes for the Scheme caps and gateways do not appropriately balance certainty and flexibility… This is an inadequate timeframe for planning long-lived, capital intensive investments.[28]

3.34 The Australian Petroleum Production and Exploration Association (APPEA) provided evidence to the committee that the change to the treatment of LNG from the Green Paper to the White Paper that provides for an allocation of permits:

> …implies that the adverse impacts on the LNG may be lessened by White Paper's policy position compared to that proposed under the Green Paper. It remains the case, however, that the industry will face a significant cost impact not faced by its competitors and customers and that the growth and development prospects of the Australian LNG industry will be adversely impacted as a direct result.[29]

Draft legislation

3.35 The exposure drafts of six pieces of legislation which the government stated will give effect to the White Paper were released on 10 March 2009. These are:

- Carbon Pollution Reduction Scheme Bill 2009

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26 See evidence from Mackay Regional Council, *Committee Hansard,* 6 April 2009, pp 32 and 33; Gladstone Regional Council, answer to question on notice, 7 April 2009 (received 24 April 2009); Wollongong City Council, *Submission 90*, pp 2-3.

27 Mr Barry Omundson, Director, Commercial Services, Mackay Regional Council and Councillor Darryl Camilleri, Deputy Mayor, Mackay Regional Council, *Committee Hansard,* 6 April 2009, pp 32 and 33.

28 Energy Supply Association of Australia, *Submission 74*, p. 7.

29 Australian Petroleum Production and Exploration Association, answer to written question on notice, 14 January 2009 (received 30 January 2009).

- Carbon Pollution Reduction Scheme (Consequential Amendments) Bill 2009
- Australian Climate Change Regulatory Authority Bill 2009
- Carbon Pollution Reduction Scheme (Charges—General) Bill 2009
- Carbon Pollution Reduction Scheme (Charges—Excise) Bill 2009
- Carbon Pollution Reduction Scheme (Charges—Customs) Bill 2009

3.36 Mr Barry Sterland, Acting Deputy Secretary of the Department of Climate Change, informed the committee that:

> The exposure draft reflects the policy positions that the government outlined in the white paper and provides a bit of further detail in some areas of how that policy will be implemented.
>
> The legislation consists of six bills. The Carbon Pollution Reduction Scheme Bill is the main bill and includes all the key provisions. The Carbon Pollution Reduction Scheme (Consequential Amendments) Bill provides for amendments to existing legislation, particularly the National Greenhouse and Energy Reporting Act and taxation legislation, to accommodate the new scheme. The Australian Climate Change Regulatory Authority Bill provides for a new regulatory body to implement the Carbon Pollution Reduction Scheme, the renewable energy target and the National Greenhouse and Energy Reporting System. Three charges bills provide for charges to be imposed for the auction of Australian emission units or for the issue of units at fixed charge in the event that these are considered to be taxes for constitutional purposes. The Commonwealth does not consider these charges to be taxes and has taken an approach of abundant caution in case a court reaches a different view on these questions at some time in the future.[30]

3.37 The report of the Senate Standing Committee on Economics on the exposure draft of this legislation was presented on 16 April 2009.

Prime Minister's announcement of 4 May 2009

3.38 On Monday 4 May 2009, the Prime Minister made a number of announcements relating to the design and implementation of the CPRS, including:

- A delay in the implementation of the CPRS from 1 July 2010 to 1 July 2011;
- Fixing the price of carbon permits until 1 July 2012;
- Protection for EITE industries for the first five years of the scheme under a 'Global Recession Buffer';

30 Mr Barry Sterland, Acting Deputy Secretary, Department of Climate Change, *Committee Hansard*, 2 April 2009, pp 62-63.

- The establishment of an Australian Carbon Trust;
- Funding for businesses to undertake energy efficiency measures from 1 July 2009; and
- A commitment to reducing Australia's carbon pollution by 25 per cent by 2020 if the world agrees to an ambitious global deal to stabilise levels of CO_2 equivalent at 450 parts per million or lower.[31]

Issues regarding the CPRS

3.39 Following is an overview of many of the issues raised by witnesses and submitters regarding the CPRS. The remainder of the report will discuss some of the issues raised with the committee in detail.

3.40 While the committee received evidence from a number of witnesses supporting an emissions trading policy approach in principle,[32] many witnesses claimed the design of the CPRS as currently proposed was flawed in that it would not achieve the emissions reductions and low cost abatement opportunities that emissions trading schemes are intended to accomplish. This again highlights the point that not all emissions trading systems are the same and the importance of properly considering the particular design features of any scheme.

Lack of environmental benefit

3.41 The committee notes the comment of Professor Ross Garnaut:

> The most inappropriate response would be to delude ourselves, taking small actions that create an appearance of action, but which do not solve the problem.[33]

3.42 The AIGN highlighted the view that the focus should be on reducing global emissions:

> If the best place to have the investment is here then that is where it ought to be, not somewhere else…we are talking about global emissions here. That is what is important. If the most efficient place to have them is in Australia then that is where they ought to be.[34]

3.43 Mr Tony Westmore, Senior Policy Officer (Electricity) of the Australian Council of Social Service argued:

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31 Australian Labor Party, 'A package of new measures for the CPRS', Media statement, 4 May 2009.

32 See also 'Policy options' section in chapter 2.

33 Professor Ross Garnaut, *Garnaut Climate Change Review: Draft Report*, p. 2.

34 Mr Michael Hitchens, Chief Executive Officer, Australian Industry Greenhouse Network (AIGN), *Committee Hansard*, 2 February 2009, p. 35.

> …we think that the targets and trajectories have been set too low and are restrained in ways that are not going to be effective. So it is certainly a concern of mine that we are going to build this machinery that is not going to be very effective at all.[35]

3.44 Ms Fiona Wain the Chief Executive Officer of Environment Business Australia further argued that the CPRS would not assist Australia in the transition to a low emission economy:

> I do not think that the CPRS, as it is outlined in the white paper, is a true market mechanism and I do not think it will deliver what we have asked for it to deliver. If it is going to be maintained as it is written down in the white paper, we are going to need some significant bolt-ons such as an energy efficiency target, a renewable energy target, a gross feed-in tariff, a soil carbon program and a legacy draw-down program to make it work and to make it commercially viable.[36]

3.45 Pacific Hydro explained that the CPRS as currently designed does not on its own provide enough financial incentive to invest in renewable energy:

> You would need something north of $60 per tonne to drive the transformational change. According to the current CPRS model that is out there, you actually do not start to see that price coming into the economy until after about 2035. That is on the CPRS minus five scenario, which is the very bottom line. Clearly, in that time, if that [the CPRS] were the only thing that you did, you would see barely any renewable energy built, and the modelling done on behalf of government demonstrates that from MMA. You would need a much higher carbon price to drive any form of changing the stationary energy sector.[37]

3.46 The committee questioned Professor Warwick McKibbin about how environmentally effective the CPRS would be. Professor McKibbin agreed that the CPRS is not as economically responsible or environmentally effective as it could be.[38]

3.47 Professor McKibbin stated 'I think you can do better than the system as it is designed.'[39]

3.48 The Australian Conservation Foundation (ACF) was unequivocal in its criticism of the environmental outcome of the CPRS:

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35 Mr Tony Westmore, Senior Policy Officer (Electricity), Australian Council of Social Service (ACOSS), *Committee Hansard,* 19 February 2009, p. 13.

36 Ms Fiona Wain, Chief Executive Officer, Environment Business Australia, *Committee Hansard*, 19 February 2009, pp 20-21.

37 Mr Andrew Richards, Executive Manager, Government and Corporate Affairs, Pacific Hydro, *Committee Hansard,* 2 April 2009, p. 40.

38 Professor Warwick McKibbin, *Committee Hansard,* 19 February 2009, p. 65.

39 Professor McKibbin, *Committee Hansard,* 19 February 2009, p. 65.

> The Carbon Pollution Reduction Scheme, as outlined in the white paper, does not constitute an environmentally effective emissions trading scheme. We do not support the introduction of the scheme as it currently stands, due to the number of major flaws. The principal concern with the Carbon Pollution Reduction Scheme and the government's policy in regard to climate change is the weak target set to reduce our emissions by the year 2020. ...Unfortunately, the way the Carbon Pollution Reduction Scheme has been proposed not only sets that weak medium-term target but actually locks it in. It prevents us from seeing how the international negotiations progress, from seeing what happens internationally, from seeing what technological solutions come to the forefront and from being able to improve over time. [40]

3.49 While Dr Brian Fisher, following questioning from the committee stated that in his opinion 'the scheme would reduce global emissions by a small amount',[41] many industry representatives also expressed the view that they believe the CPRS will not lead to a decrease in global emissions, and would have a negative impact on the Australian economy and employment. For example BlueScope Steel stated:

> …we believe the current scheme is going to lead to outcomes that do not reduce global greenhouse gas emissions and certainly it is not going to help the Australian economy or the people of the Illawarra.[42]

3.50 The Cement Industry Federation argued that if the CPRS as outlined in the Green Paper was implemented:

> …we might get to a situation where Australia reaches its cap. I have no doubt that we would do our darnedest as a nation to reach our cap, but we would simply add to the climate change problem. We could stand up nationally and say that we had reached our cap, but globally we would simply add to climate change. I think that is fraudulent.[43]

3.51 Mr Michael Ison, Acting Executive Director of the Australian Aluminium Council (AAC) stated that the CPRS will lead to lost local production costing the Australian economy, while ultimately more carbon will be emitted into the global atmosphere.[44]

> Senator BUSHBY—Carbon leakage will shift. We effectively will lose production here to the cost of our economy and ultimately end up with

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40 Mr Owen Pascoe, Climate Change Campaigner, Australian Conservation Foundation (ACF), *Committee Hansard*, 2 February 2009, pp 77-78.

41 Dr Brian Fisher, *Committee Hansard,* 2 April 2009, p. 52.

42 Mr Alan Thomas, General Manager Engineering, Technology and Environment, BlueScope Steel, *Committee Hansard,* 1 April 2009, p. 28.

43 Mrs Robyn Bain, Chief Executive Officer, Cement Industry Federation, *Committee Hansard,* 19 November 2008, p. 107.

44 Mr Michael Ison, Acting Executive Director, Australian Aluminium Council (AAC), *Committee Hansard*, 8 December 2008, p. 38.

> more tonnes of CO2 gas and equivalents going into the atmosphere globally.
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> Mr Ison—That is correct, yes.[45]

Timing of the implementation of the CPRS

3.52 An overwhelming number of witnesses who presented evidence to the committee explained that the foremost priority regarding the CPRS is ensuring the design of the scheme is appropriate, regardless of the government's preferred implementation schedule. As discussed in chapter 2, a number of witnesses highlighted the importance of not rushing the introduction of the CPRS especially given the current global financial crisis.

3.53 The Chamber of Commerce and Industry (CCI) of Western Australia stated:

> …the implementation date is less important than getting a system designed that will work appropriately. Global action will also have a significant impact on it. So we are not saying that 2010 is a necessary start date. We would prefer to see a design put in place that could be fully supported by industry and would provide a solid foundation for a working scheme.[46]

3.54 This was echoed by the Minerals Council of Australia (MCA):

> Our view is that the time line for the start of an emissions trading scheme will look after itself if you get the framework right. Getting the framework right is the absolute, fundamental priority.[47]

3.55 A number of concerns were raised regarding what some witnesses described as an 'ambitious' timetable for the implementation of the scheme.

3.56 Mr Gordon Keen, GHG Issue Manager from ExxonMobil Australia, explained how aggressive the proposed CPRS implementation timetable is and compared it with that of the European Union ETS:

> …the schedule for implementation of an Australian ETS represents one of the most aggressive timetables ever contemplated. This approach stands in contrast to the preparation and implementation of the only broad based ETS that has been undertaken internationally, namely that in Europe. The EU commenced its planning for an ETS in 2000 and continued planning for five years before then implementing a trial system that was undertaken for a further three years. This was a planning process and trial that experienced

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45 Senator David Bushby, Member of the Senate Select Committee on Fuel and Energy, and Mr Ison, AAC, *Committee Hansard,* 8 December 2008, p. 38.

46 Mr Andrew Canion, Senior Adviser, Industry Policy, Chamber of Commerce and Industry (CCI) of Western Australia, *Committee Hansard,* 17 November 2008, p. 14.

47 Mr Mitchell Hooke, Chief Executive, Minerals Council of Australia (MCA), *Committee Hansard,* 8 December 2008, p. 5.

> significant difficulties across its implementation, even up to the closing months of that trial in 2007.
>
> The lessons from the European experience may not even now be fully understood. Despite this example, the Australian government is proposing to implement an ETS in under two years. This aggressive schedule poses a potentially significant implementation risk.[48]

3.57 Chevron Australia further demonstrated this point, referring to the example of the North American acid rain program:

> We are looking at a period of less than six months between having the legislation in place and having the scheme go live, and we feel that is perhaps fraught with difficulties for government and industry in terms of preparing for its implementation. It runs the risk that we will go into a scheme and there will be difficulties, teething problems, in the first years that will need to be rectified, and that will mean changes to legislation and what have you. We do not think that is in anybody's interest.
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> If you contrast that with the North American acid rain program, after they passed legislation for that program, it was three or four years before the scheme actually went live. That provided three or four years where government could get its regulatory framework established and running and where industries, in particular, could prepare for its implementation. That scheme, in contrast to, say, the European emissions trading scheme, has worked, and it has worked successfully from day 1. That is an illustration of how important it is for the implementation of these things to be well thought through and to allow plenty of time for them to be implemented effectively.[49]

3.58 The CCI of Western Australia questioned the rush to implement the scheme:

> Given the relatively small emissions reductions target selected by Government CCI questions the need for urgent scheme commencement. A smaller target is more easily achieved and therefore delaying commencement is unlikely to have a significant impact on the nation's ability to meet its 2020 target. CCI believes the benefits that would accrue from having all industry sectors fully prepared for introduction of the CPRS would offset any short delay in commencement.[50]

3.59 Some witnesses articulated concerns about delaying the implementation of the scheme, due to the detrimental impact any delay would have on business certainty,

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48 Mr Gordon Keen, ANZ GHG Issue Manager, ExxonMobil Australia, *Committee Hansard*, 8 December 2008, pp 42-43.

49 Mr John Torkington, Senior Adviser on Climate Change Policy, Chevron Australia, *Committee Hansard*, 18 February 2009, pp 26-27.

50 Chamber of Commerce and Industry of Western Australia, answer to written question on notice, 14 January 2009 (received 21 January 2009).

however the majority also highlighted the importance of getting the design right. As Ms Belinda Robinson the Chief Executive of APPEA explained:

> There has been a lot of debate around whether we should delay or not. It is our view that we should not. It is our view not so much that we should not, but that the scheme must be designed properly to take into account the sorts of issues that we have raised. If it is designed properly when it is introduced really becomes irrelevant; it becomes delayed because more time is required to get the policy settings right, and that is one thing. But it is true that the longer we delay, the more uncertainty there is.[51]

3.60 A number of witnesses suggested that a trial, or 'soft start' approach be considered by the government as an alternative, allowing the scheme to be implemented without causing any harm to the economy and providing the opportunity to adjust the scheme as necessary after observing it in practice.

3.61 ExxonMobil Australia outlined such a suggestion to the committee in detail:

> …our view is that serious consideration should be given to a phased approach similar to that used in the EU in which the early years of the proposed scheme are implemented fully but considered to be a trial to ensure that mechanisms chosen are appropriate and do not do undue harm to the Australian economy and the wellbeing of its citizenry. In a trial, market stabilisation measures such as a cost containment mechanism or price cap may also be tested to determine their effectiveness in reducing the risks and uncertainties associated with the emissions trading scheme. A trial period through to the end of the first Kyoto round in 2012 would appear to be allowable and appropriate, particularly if trends continue to indicate that Australia will meet its commitment at that time. Such phasing would also allow industry time to make the substantial physical and systems changes that will be required to operate within an ETS with a minimum of risk.[52]

3.62 Mr Gregory Evans the Director Economics for the Australian Chamber of Commerce and Industry added further:

> …the other reason for that soft start is that even at this stage we do not know the extent to which other countries will be joining the scheme and at what time that will happen, so we are still firmly of the view that we need to align our policy response with countries that we compete with.[53]

3.63 Mr Peter Colley National Research Director from the Construction, Forestry, Mining and Energy Union argued that the scheme as currently proposed constitutes a soft start:

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51 Ms Belinda Robinson, Chief Executive, Australian Petroleum Production and Exploration Association (APPEA), *Committee Hansard*, 19 November 2009, pp 37-38.

52 Mr Keen, ExxonMobil Australia, *Committee Hansard*, 8 December 2008, p. 43.

53 Mr Gregory Evans, Director Economics, Australian Chamber of Commerce and Industry, *Committee Hansard*, 8 December 2008, p. 66.

> The fact that a substantial amount of compensation in the form of free permits has been allocated to emissions-intensive trade-exposed industries clearly is a soft start. The fact that compensation has been promised to strongly affected industries indicates a soft start…the scheme will have enough of a soft start that it will not impose high costs on energy.[54]

3.64 Dr Brian Fisher summed up the debate:

> I think extreme care needs to be taken and that is one of the reasons why I said previously that, if this scheme is going to be introduced on the current government's timetable, then one option would be to cap the price at, say, $5 a tonne for a significant amount of time. I think there are good arguments for doing something like that. I think that we are going to have, at some point in time, an emissions trading scheme in the in [sic] Australian economy...Inevitably, as I also said before, this is the most complex piece of legislation and set of changes that have been proposed for the Australian economy probably ever, and we are trying to do it within a very short time frame. With the best will in the world, there will be mistakes, but at the same time, if we are going to have one of these things in the future, you should give industry the chance of having what you might call a practice run. Also, the regulators need a practice run.[55]

An ambitious and complex scheme

3.65 A number of witnesses and submitters expressed concern that in adopting the CPRS, Australia would be committing itself to a more aggressive regime than other countries.

3.66 Mr Keen of ExxonMobil Australia expressed concern that due to the comprehensive nature of the scheme, the scale of its implementation could lead to confusion or error which would result in problems, and a lack of confidence in the scheme.[56]

> …[The CPRS is] the most complex and most advanced regulatory regime of its kind to be put forward by government anywhere in the world. The Australian ETS would be the first scheme to cover all greenhouse gases, include transport fuels, natural gas and fugitive emissions, and move to a hard start-up with significant auctioning of permits in 2010.[57]

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54 Mr Peter Colley, National Research Director, Mining and Energy Division, Construction, Forestry, Mining and Energy Union (CFMEU), *Committee Hansard*, 19 November 2008, p. 121.

55 Dr Fisher, *Committee Hansard,* 2 April 2009, pp 61-62.

56 Mr Keen, ExxonMobil Australia, *Committee Hansard*, 8 December 2008, p. 52.

57 Mr Keen, ExxonMobil Australia, *Committee Hansard*, 8 December 2008, p. 42.

3.67 Mr Michael Hitchens, Chief Executive Officer of AIGN, commented, 'at the moment the White Paper is committing Australia to something that is far more expensive than those comparable advanced countries.'[58]

3.68 Mr Peter Coates, Chairman of the MCA, echoed these concerns, stating:

> The proposed trading scheme is out of step with schemes being developed around the world. It goes further and faster than any comparable scheme either in existence or being contemplated. It is the world's most aggressive emissions trading scheme…No other emissions trading scheme has ever embraced full auctioning of permits, let alone from the start of the scheme...All of the emissions trading schemes in operation or being developed around the world adopt a phased approach to auctioning…[59]

3.69 Dr Fisher added that the ambitious nature of the CPRS would have implications regarding the timing of the scheme's implementation:

> We are proposing a scheme that is, as I understand it, the most ambitious scheme of this type contemplated anywhere. The government is a leader in terms of its ambition with respect to coverage and complexity with the scheme that is being introduced here. This has all sorts of implications in terms of uncertainty about investment in Australia and it is not clear to me at all that we can get the design of the current scheme right in the short period of time that has been allocated.[60]

3.70 AIGN noted concerns that the emissions reduction targets set in the White Paper are too high:

> AIGN endorses the White Paper test for setting Australia's emission budget at a level that is commensurate with "advanced economies taking on reductions comparable to Australia". Unfortunately, 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. AIGN advocates that Australian's shoulder a fair share of the global burden, no more and no less.[61]

3.71 The committee also heard evidence stating that the CPRS does not go far enough to encourage an effective global agreement, with the ACF calling for a commitment to cut emissions by between 25 and 40 per cent by 2020:

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58 Mr Hitchens, AIGN, *Committee Hansard*, 2 February 2009, p. 41.

59 Mr Peter Coates, Chairman, Minerals Council of Australia, *Committee Hansard,* 8 December 2008, pp 2-3.

60 Dr Fisher, *Committee Hansard*, 2 April 2009, p. 53.

61 AIGN, answer to written question on notice, 14 January 2009 (received 23 January 2009).

> …it is in Australia's national interests to achieve an effective international agreement. In order to bring about circumstances where an effective international agreement might come in, we would like to see our government advocating for targets that would be part of that effective agreement.[62]

3.72 The committee has not been provided with any evidence of a discernable advantage to Australia flowing from 'leading the world' in introducing the most complex and aggressive emissions trading scheme. To the contrary, the anticipated negative impact on Australia's economy and jobs of such a scheme, without achieving a clear environmental benefit, would more than likely provide a disincentive for other nations.

Recognition of individual action to reduce emissions

3.73 The committee also heard concerns about the failure of the CPRS as currently designed to properly recognise and provide incentives for individuals and households to reduce emissions:

> …the system as it is currently proposed means that if householders save energy the benefit is going to go to the large emitters…this really needs to be addressed.[63]

3.74 This point was also made by Mr Tony Westmore of the Australian Council of Social Service:

> …it seems to be true that the CPRS may act perversely to disincentivise people taking action to reduce emissions…simply because if you take action to reduce emissions you increase the number of permits that are available to other people—you might reduce the price of permits and you might actually encourage pollution.[64]

3.75 The ACF raised concerns about:

> …the lack of the ability of the Australian public to contribute to reducing emissions beyond the national target that is set. For example, if a householder decided to install solar panels on their roof after the Carbon Pollution Reduction Scheme came in, that would not deliver one kilogram of greenhouse gas reduction beyond the national target that has been set. It would only serve to reduce the cost of the Carbon Pollution Reduction Scheme. We think that is a serious flaw that needs to be addressed and can be addressed by a better designed system.[65]

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62 Mr Owen Pascoe, ACF, *Committee Hansard*, 2 February 2009, p. 79.

63 Dr Judy Messer, President, Futureworld National Centre for Appropriate Technology, *Committee Hansard*, 1 April 2009, p. 6.

64 Mr Westmore, ACOSS, *Committee Hansard*, 19 February 2009, p. 9.

65 Mr Owen Pascoe, ACF, *Committee Hansard*, 2 February 2009, p. 78.

3.76 Dr Judy Messer, President of the Futureworld National Centre for Appropriate Technology, noted that one way of effectively recognising these efforts would be to:

> …give these credits to not-for-profit environmental organisations that can demonstrate that they are working to encourage energy efficiency and energy conservation or to promote appropriate technologies.[66]

3.77 The Australian Capital Territory (ACT) government also noted concerns that the CPRS would limit the ability of states and territories to contribute to further emissions reductions. The ACT Minister for Energy, the Hon. Mr Simon Corbell MLA noted:

> …we are concerned that actions by states and territories to go beyond the targeted CPRS reductions may not achieve real emission reductions, as these actions may not correspond to fewer emission permits. Further investigation by the Commonwealth is required to identify whether efforts by states and territories to go beyond the targeted CPRS reductions can meaningfully contribute to reducing emissions…It is a significant concern of mine that state and territory jurisdictions may not be able to implement more stringent climate change policies that contribute to achieving real reductions in emissions…If this is the case, the coverage of the CPRS severely limits the scope for the ACT to take effective action on climate change.[67]

Design issues

3.78 The committee also heard a broad range of concerns regarding the design of the scheme.

3.79 Professor McKibbin noted a series of problems with the CPRS, summarised as follows:

- horizons in the scheme are too short;
- the initial reduction commitment does not go far enough, and there is no flexibility to make deeper cuts if this is desired;
- as the price of carbon is determined by the market, short term price volatility could be quite high; and
- the scheme imposes a significant cost burden on industries which are already under pressure, reducing their capacity to innovate, and their ability to obtain finance.[68]

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66 Dr Messer, Futureworld National Centre for Appropriate Technology, *Committee Hansard*, 1 April 2009, p. 6.

67 Australian Capital Territory Government, answer to written question on notice, 16 January 2009 (received 23 February 2009).

68 Professor McKibbin, *Committee Hansard*, 19 February 2009, pp 64-65 and 68-69.

3.80 The Queensland Resources Council told the committee that they do not believe the design of the CPRS is flexible enough to deal with cycles in the economy:

> Mr Roche—…we believe the design of an emissions trading scheme needs to be able to deal with the cycles of the economy. We are currently in a very difficult part of that cycle. There will be further such down-cycles in coming years, as it ever has been thus. So we are saying that an emissions trading scheme needs to be able to be calibrated to deal with the ups and downs of the economy rather than saying that there is something special about the current down-cycle such that we have to deal with the design of the scheme. We believe the design of the scheme needs to be able to cope with the ups and downs of the economy.
>
> CHAIR—Do you think that the current design does that?
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> Mr Roche—Not to our satisfaction.[69]

3.81 Chevron Australia noted that an organisation's ability to reduce emissions is not determined by the pricing of carbon:

> …having to outlay that money to buy emissions permits does not actually change your motivation to reduce emissions. This is a fundamental problem with the CPRS. There seems to be a view behind the CPRS that firms have to physically be out of pocket to have any incentive to reduce emissions, and that is not the case. Our ability to reduce emissions is set by the price in the market and our marginal costs of abatement, not by whether we have permits allocated to us or have to purchase them—that is, a cost impost on an industry and on a project does not actually change the ability to reduce emissions anywhere.[70]

3.82 The ACF took the view that the compensation provided for under the CPRS is 'excessive'.[71] Mr Daniel Price, Managing Director of Frontier Economics explained that the compensation provided for creates distortions and inefficiencies when modelled.[72]

3.83 Mr David Pearce, Executive Director of the Centre for International Economics described these inefficiencies to the committee:

> …the idea of attempting to increase the carbon price in the economy and then shielding the people who you are wanting to influence with that price increase is inefficient. That is one layer of inefficiency. The other layer of inefficiency is that large organisations that will have large permit

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69 Mr Michael Roche, Chief Executive, Queensland Resources Council, *Committee Hansard*, 20 February 2009, and Senator Mathias Cormann, Chair of the Senate Select Committee on Fuel and Energy, *Committee Hansard,* 20 February 2009, pp 29-30.

70 Mr Torkington, Chevron Australia, *Committee Hansard,* 18 February 2009, p. 25.

71 Mr Owen Pascoe, ACF, *Committee Hansard*, 2 February 2009, p. 78.

72 Mr Daniel Price, Managing Director, Frontier Economics, *Committee Hansard,* 2 April 2009, pp 12-13 and 20-21.

> requirements in order to operate, to the extent that they are purchasing auction permits, will essentially be transferring a lot of income to the Treasury. It goes off their balance sheet, if you like, and it makes it very hard for those organisations to raise funds and do the kinds of investments they may need to do in order to increase their energy efficiency.[73]

3.84 Mr Price summarised the concerns of a number of witnesses stating:

> I think that this scheme will be a catastrophe. I do think that it will not work, it is high cost and it will give emissions trading a bad rap…[74]

International trading of permits

3.85 Various witnesses noted a series of possible issues associated with the ability to trade carbon permits internationally. In particular the committee heard concerns that the ability to import permits from overseas could result in no reductions in Australia's domestic emissions,[75] thus raising concerns about the environmental effectiveness of the scheme.

3.86 The summary of the Department of the Treasury's modelling report *Australia's Low Pollution Future: The Economics of Climate Change Mitigation – Summary*, stated:

> International trade can reduce the cost of achieving emission reduction targets because it allows mitigation to occur wherever it is cheapest. Trade does not compromise the environmental objective, because Australia's 'excess' emissions are offset by lower emissions in economies that export permits.[76]

3.87 Dr Fisher explained that there is a risk that as a result of international permit trading, the Australian carbon price will be driven by the international carbon price:

> …under the current proposal, the Australian carbon price will basically be dominated by what the international carbon price is. According to the Treasury modelling, effectively we are doing a large share of our abatement by import of permits. The proposal is that our scheme be linked to international carbon prices. Because Australia is a small, open economy, the international carbon price will drive the Australian carbon price—there can be no doubt about that…[77]

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73 Mr David Pearce, Executive Director, Centre for International Economics, *Committee Hansard*, 2 April 2009, p. 29.

74 Mr Price, Frontier Economics, *Committee Hansard,* 2 April 2009, p. 24.

75 Mr Price, Frontier Economics, *Committee Hansard,* 2 April 2009, p. 23.

76 Australian Government, *Australia's Low Pollution Future: The Economics of Climate Change Mitigation – Summary*, October 2008, p. 25.

77 Dr Fisher, *Committee Hansard*, 2 April 2009, p. 56.

3.88 Mr Stephen Gale of the Futureworld National Centre for Appropriate Technology, noted that international trade in permits could result in Australian efficiencies being driven offshore:

> …the purchase of permits from overseas should be restricted because we should be designing the scheme to drive for maximum efficiency in Australian industry. If we do not request that Australian industry be as efficient as possible there is a risk that we will lose global competitiveness by transferring those efficiency improvements to developing nations.[78]

3.89 The committee considers that what matters is achieving a reduction in global greenhouse gas emissions and that as such the level of domestic emissions is not and should not be the primary consideration. In that context, the international trading of permits can be an important and appropriate part of a proper global framework to reduce greenhouse gas emissions.

Limitations of the Kyoto Protocol

3.90 Throughout the inquiry the committee heard evidence on issues regarding the Kyoto Protocol, which impact on how a domestic Australian ETS would operate.

3.91 Ms Robinson, of the APPEA, explained to the committee that while LNG produced in Australia increases domestic emissions, its export and substitution for coal in the generation of power in other countries leads to a global reduction in emissions. However, '…the Kyoto accounting rules do not enable the full benefits of those global savings to accrue back to Australia.'[79]

3.92 Mr Michael Angwin, the Executive Director of the Australian Uranium Association, explained to the committee that the exclusion of nuclear power under the Kyoto Clean Development Mechanism is an 'unnecessary limitation':

> There is a Clean Development Mechanism under the Kyoto protocol, and its purpose is to help mitigate greenhouse gas emissions where it is cheapest to do so. It supports, in effect, the investment by companies from developed countries in developing countries to build mechanisms for mitigating greenhouse gases where it is cheapest to do so. Currently, the Clean Development Mechanism does not permit nuclear power to be one of those mechanisms…[80]

3.93 Mr Michael Keogh, Executive Director of the Australian Farm Institute, further explained this limitation on mitigation measures to the committee:

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78 Mr Stephen Gale, Regional Director Climate Change, Futureworld National Centre for Appropriate Technology, *Committee Hansard*, 1 April 2009, p. 6.

79 Ms Robinson, APPEA, *Committee Hansard*, 19 November 2009, p. 26.

80 Mr Michael Angwin, Executive Director, Australian Uranium Association, *Committee Hansard*, 8 December 2008, p. 19.

> Under the current accounting methodologies, which we are bound to under the Kyoto protocol, the mitigation strategies are limited to reforestation—farm forestry. There is no opportunity, for example, to look at sequestration in soils or those sorts of things…It [the Kyoto Protocol] has locked us into a mode of accounting which dramatically limits the potential mitigation measures…[81]

3.94 When the Leader of the Opposition, the Hon. Malcolm Turnbull MP announced the Coalition's Green Carbon Initiative in January 2009, including a proposal to 'pursue sequestration of large quantities of carbon via biochar (the conversion of biomass into charcoal, which can be fixed in soil),'[82] the Minister for Climate Change and Water, Senator the Hon. Penny Wong, responded on behalf of the government with the following statement:

> Soil carbon (including biochar) does not fit within the scope of the current Kyoto Protocol accounts, so is not included at this time in the Carbon Pollution Reduction Scheme.[83]

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

Auctioning of permits

3.96 The committee heard concerns about the extent of auctioning of permits as proposed under the CPRS. The MCA explained:

> The scheme proposes full auctioning, other than 20 per cent of free permits for a small proportion of Australia's trade-exposed sector. The result is that Australian businesses will pay the highest carbon costs in the world by a very wide margin. No other emissions trading scheme has ever embraced full auctioning of permits, let alone from the start of the scheme. For example, for the first eight years of the EU scheme, more than 98 per cent of permits will be issued free. Only after 2013 will some European firms have to buy some of their permits.[84]

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81 Mr Michael Keogh, Executive Director, the Australian Farm Institute, *Committee Hansard*, 19 February 2009, pp 35-36.

82 See the Hon. Malcolm Turnbull MP, Leader of the Opposition, 'The Coalition's Green Carbon Initiative', Press Release, 24 January 2009.

83 Bronwyn Herbert, 'Opposition supports Biochar research', *The 7:30 Report*, Transcript, Senator the Hon. Penny Wong, Minister for Climate Change and Water, 26 January 2009.

84 Mr Coates, MCA, *Committee Hansard*, 8 December 2008, p. 2.

3.97 The MCA argued that a phased approach to the auctioning of permits would be more appropriate, and would yield better results for the Australian economy:

> Every single country that is looking at a cap and trade system is doing so on a phased approach to full auctioning…We have modelled our proposal, and it comes out that every single factor that you would expect to be critical, such as GDP, investment, employment, real after-taxes wages and exports, will be higher under a phased approach to auctioning.[85]

3.98 While ExxonMobil Australia stated:

> The Australian ETS would be the first scheme to cover all greenhouse gases, include transport fuels, natural gas and fugitive emissions, and move to a hard start-up with significant auctioning of permits in 2010.[86]

3.99 ExxonMobil Australia also stated that they support 100 per cent auctioning of permits, subject to transitional measures, on the basis that it is a simple and equitable approach.[87]

3.100 The Energy Supply Association of Australia argued that they are 'supportive of the White Paper's long term objective of moving towards 100 per cent auctioning of permits after sufficient administrative allocations have been made.'[88]

3.101 BP Australia also stated that it supports full auctioning of permits with the exception of those allocated for EITE assistance.[89]

Interaction of the CPRS with other regulation

3.102 The committee received evidence from the electricity generation sector raising concerns about the regulation of retail electricity prices. The National Generators Forum (NGF) informed the committee that, with the exception of Victoria, retail electricity prices are regulated at a state level. Mr Carlo Botto, a Director of the NGF noted that the CPRS will impact on the cost of energy, however:

> Whether ultimately that cost is passed on to the consumer is a function of whether the retail price is allowed to reflect that increased cost…the imposition of the CPRS is a federal policy position but, right now, in most of the states of Australia the maximum price paid by the consumer is managed by the states. So we have to make sure that there is an ability to pass on the cost reflected in the price that is allowed to be charged.

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85 Mr Hooke, MCA, *Committee Hansard*, 8 December 2008, p. 7.

86 Mr Keen, ExxonMobil Australia, *Committee Hansard*, 8 December 2008, p. 42.

87 Mr Keen, ExxonMobil Australia, *Committee Hansard*, 8 December 2008, p. 56; ExxonMobil Australia, *Submission 66*, p. 9.

88 Energy Supply Association of Australia (ESAA), *Submission 74*, p. 8.

89 Mr Mark Proegler, Director, Environmental Policy, BP Australia, *Committee Hansard*, 17 February 2009, p. 47.

…

The wholesale price of electricity under the current proposed scheme will roughly double by 2020 and will probably triple by about 2025.

…

…the coal-fired sector, in particular, which is currently a very low-cost producer, does not usually set the commodity price for electricity. But that is the sector that will bear the burden of the costs of carbon. As a consequence, that sector will have a margin squeeze…[90]

3.103 The Energy Supply Association of Australia (ESAA) echoed these concerns:

The regulation of retail electricity prices poses significant threat to the efficient operation of CPRS and the viability of retailers. For the scheme to operate efficiently and provide least cost emission reductions, consumers must be exposed to the cost implications of greenhouse gas emissions. Retail price regulation would prevent retailers from passing on higher wholesale energy costs in a timely manner. Retailers could experience significant losses and be unable to contract forward with the remaining generators, forcing their eventual exit. Systemic failure or financial distress among major retailers would increase volatility and risks in the energy market and undermine reliability and security of supply.[91]

3.104 Further, in its submission to the committee, the ESAA stated:

…retail price regulation should be removed. However, where Governments are unwilling to commit to this reform, at the very least there should be a consistent, national framework for the regulation of retail prices that enables cost reflective pricing and the full pass-through of emission costs to consumers. The Australian Energy Market Commission should determine the appropriate methodology for ensuring cost-reflectivity and it should be applied by the Australian Energy Regulator.[92]

3.105 The committee was informed that unless the 'plethora' of federal and state regulations are removed, the CPRS will not be an efficient ETS.[93] In its submission, ExxonMobil Australia noted that in light of the CPRS, a series of state and federal policies require review:

ExxonMobil believes there is an array of energy and fiscal policies at the state and federal level that would undermine the efficacy of any carbon price signal. In particular we would identify several areas that require specific review – mandated energy efficiency programs, mandated

90 Mr Carlo Botto, Director, National Generators Forum, *Committee Hansard*, 2 February 2009, pp 10-11.

91 Ms Clare Savage, Acting Chief Executive Officer, Energy Supply Association of Australia (ESAA), *Committee Hansard*, 2 February 2009, p. 18.

92 ESAA, *Submission 74*, p. 10.

93 Mr Hitchens, AIGN, *Committee Hansard*, 2 February 2009, pp 34-35.

> technological requirements to mitigate emissions, mandated quotas for different energy sources that compete in the energy supply market and fiscal disparities (taxes and/or subsidies) which create distortions between competing energy sources.[94]

3.106 Chevron Australia supported the rationalisation of existing policies which regulate greenhouse gases, stating:

> The continuation of many of these policies will ultimately undermine the economic and environmental effectiveness of the CPRS and will do little to further emissions reductions when we have the CPRS in place.[95]

3.107 Conversely, the committee also heard evidence calling for additional regulation to the CPRS. The National Institute of Economic and Industry Research told the committee that a carbon price as imposed via the CPRS will not drive the required efficiency adjustments and emissions reductions, and consequently, 'you need mandating, regulation and PPP[96] type arrangements to force the energy efficiencies into the system.'[97]

3.108 On a practical level, the ESAA noted that the regulatory framework will need to accommodate the needs of a low emission energy supply system which would incorporate varied generation sources and different usage patterns.[98]

3.109 The Department of Climate Change advised the committee that the Commonwealth Government hoped that various state based policies would be wound up with the introduction of the CPRS.[99]

3.110 Envirogen, an organisation which uses waste coal gas to generate power, thereby providing a form of abatement, informed the committee their industry has not been recognised under the White Paper, and that if state based renewable energy policies are removed, their industry will become unviable. Envirogen argued that power generation from waste coal gas should be recognised as a renewable energy source under the Renewable Energy Target as it has been in Germany.[100]

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94 ExxonMobil Australia, *Submission 66*, p. 14.

95 Mr Peter Eggleston, External Affairs Manager, Chevron Australia, *Committee Hansard*, 18 February 2009, p. 22.

96 Public private partnership.

97 Dr Peter Brain, Executive Director, National Institute of Economic and Industry Research, *Committee Hansard*, 17 February 2009, pp 21-22.

98 ESAA, *Submission 74*, p. 3.

99 Mr Barry Sterland, Acting Deputy Secretary, Department of Climate Change, *Committee Hansard*, 2 April 2009, p. 85.

100 Dr David Hamill, Chairman, Envirogen, *Committee Hansard*, 1 April 2009, pp 39-40 and 42.

3.111 The committee raised the case of Envirogen with the Department of Climate Change. The department explained that the government has identified Envirogen as an entity which will be affected by transitional issues in the move from state based schemes to the CPRS, and that the government 'was particularly interested in assisting those industries, and those discussions are ongoing.'[101]

Interaction of the CPRS with the Renewable Energy Target

3.112 The committee received evidence that the Renewable Energy Target (RET) is inconsistent with the government's stated aim of reducing carbon pollution 'efficiently'.[102] The evidence indicated that the RET will not lead to a least cost path to emissions reductions and will lead to overregulation which will result in inefficiencies. The committee also received evidence that the CPRS does not do enough to encourage the adoption of renewable energy technologies and therefore the RET is necessary to assist the transition to renewable energy.

3.113 The Queensland Resources Council argued that the RET:

> …adds to the cost. It is not consistent with a least cost path to emissions reductions. What we support is the price discovery through the cap and trade system. What the renewable target does is overlay a further set of price signals and some quite difficult to achieve outcomes in relation to renewable generation between now and 2020.[103]

3.114 Chevron Australia argued:

> In terms of the principles, mandatory renewable targets are going to mandate primarily wind powered generation in this country. What that will potentially do is displace other lower cost forms of abatement. You could use an example that one of the lowest cost ways we can reduce our emissions is to increase the proportion of gas-fired power generation in the country compared to coal-fired generation. There has been quite a lot of modelling done, which has been provided to government, that indicates you could deliver emissions abatement at probably half the cost through promoting gas-fired power generation rather than by promoting wind turbine generation in the marketplace. Effectively, what renewable energy targets do is that they result in higher electricity prices than would otherwise have been the case if lower cost abatement had been taken up through a market based mechanism.
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> …
>
> We would argue that we want to get away from a framework where governments are prescribing what people should be doing and…Leave it for

101 Mr Sterland, Department of Climate Change, *Committee Hansard*, 2 April 2009, p. 85.

102 Australian Government, *White Paper*, December 2008, p. xxv.

103 Mr Roche, Queensland Resources Council, *Committee Hansard*, 20 February 2009, p. 31.

> the market to determine what is the lowest cost way to reduce emissions…[104]

3.115 This argument was supported by evidence presented to the committee by the Australian Pipeline Industry Association:

> The renewable energy target is a scheme that will decrease the use of natural gas. It could act against the government's intention to reduce carbon emissions because I understand that the renewable energy technology will not be ready quickly. The extra cost involved in introducing renewable energy could see power generators retaining coal—moving to coal or keeping coalfired power—because of the extra costs involved in enforced renewable energy. That does not fix the problem of reducing emissions, because it delays the move to natural gas. However, once renewable energy is introduced most of the renewable energy systems will need natural gas as a backup fuel because of the intermittent nature of renewable energy.[105]

3.116 A similar argument was put to the committee by APPEA who explained to the committee that modelling they commissioned to assess the impact of the RET:

> …demonstrates that meeting that target will come at the cost of gas…to the tune of around 10,000 gigawatt hours…By artificially carving out what would otherwise have been the emissions trading market to one of the highest cost forms of energy comes at the cost of natural gas and squeezes natural gas.[106]

3.117 The committee notes that if this is the case, Australia's domestic policy, in the form of the RET, will lead to increased global emissions, in direct contradiction to the government's stated environmental objective.

3.118 AIGN further noted that:

> Every independent review undertaken, including by Professor Garnaut, the Productivity Commission and the Treasury, has recommended that the current MRET scheme should not be expanded and should be phased out.[107]

3.119 The CFMEU argued that without the RET, the CPRS 'will just cause a dash for gas.'[108]

3.120 The Clean Energy Council argued that the RET is not a low cost approach, but:

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104 Mr Torkington, Chevron Australia, *Committee Hansard*, 18 February 2009, pp 29-30.

105 Ms Cheryl Cartwright, Chief Executive, Australian Pipeline Industry Association, *Committee Hansard*, 19 November 2008, p. 87.

106 Ms Robinson, APPEA, *Committee Hansard,* 19 November 2008, p. 27.

107 AIGN, answer to written question on notice, 14 January 2009 (received 23 January 2009).

108 Mr Colley, CFMEU, *Committee Hansard,* 19 November 2008, p. 113.

> …critics of pursuing a low-cost response assume that we know the answer to the challenge of transitioning energy supply under the threat of climate change, and we do not. That is why we are proposing a RET. The second is that we do not know what the technology mix looks like, so it is policy designed to find out what we can do. …taking a lowest cost approach from the outset is unlikely to discover the full potential of those opportunities.[109]

3.121 Pacific Hydro noted that the RET will reduce the efficiency of the CPRS in the short term, but will guarantee the establishment of a renewable energy industry in Australia.[110]

> Unfortunately, we cannot see that the CPRS as it is currently designed would deliver an economic signal that would start to transform the stationary energy sector, whether that be in renewable energy, clean coal, carbon capture and storage or a whole range of other things…Therefore, the complementary measures that have been talked about briefly today are absolutely crucial, we believe, to that transformation of the stationary energy sector.
>
> …
>
> Effectively, we see the renewable energy target as an insurance policy for the short term. By short term we mean the next 10 to 15 years, while we wait for the CPRS to get into its stride and to deliver that broad price across the economy that will drive emissions down.[111]

3.122 Mackay Sugar described the process the organisation uses to convert waste from sugar production into a renewable fuel to generate the energy required to run its Racecourse Mill. The organisation is planning to use this technology to build a large co-generation plant. Mackay Sugar explained to the committee that:

> Legislation of the 20 per cent renewable energy target is an essential and urgent prerequisite for the co-generation project to proceed. However, the CPRS, the Carbon Pollution Reduction Scheme, will indirectly assist the projects due to the likely increase in wholesale electricity prices. Similarly, increases in petrol prices will assist the viability of our ethanol project into the future.[112]

Recognition of early mitigation actions taken by emitters

3.123 The committee questioned witnesses about the impact of the CPRS on industries which have already taken action to mitigate emissions.

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109 Mr Matthew Warren, Chief Executive Officer, Clean Energy Council, *Committee Hansard,* 17 February 2009, p. 5.

110 Mr Bernard Wheelihan, Chair, Pacific Hydro, *Committee Hansard,* 2 April 2009, p. 45.

111 Mr Richards, Pacific Hydro, *Committee Hansard,* 2 April 2009, pp 37-38.

112 Mr John Hodgson, Projects Manager, Mackay Sugar, *Committee Hansard,* 6 April 2009, p. 17.

3.124 Mr Andrew Canion of the Chamber of Commerce and Industry of Western Australia noted that early action should be recognised:

> It is important to recognise early action and provide some credit for that. You have to have a starting point. It is a difficult policy position, but we believe that industries that have undertaken early action should be recognised and potentially rewarded in some way through policy development.[113]

3.125 The Australian Academy of Technological Sciences and Engineering also argued that environmentally efficient practices should be rewarded, 'we need to reward the people who have spent the money already and are operating at world's best practice. They should be rewarded by being given free permits.'[114]

3.126 Mrs Robyn Bain, Chief Executive Officer of the Cement Industry Federation stated 'The green paper does not refer to previous gains that any industry has made.'[115]

3.127 Mrs Bain explained her views regarding the impact of the CPRS given the cement industry has previously made considerable reductions in emissions:

> Mrs Bain—It depends on whether or not the department or the government chooses the path of industry averaging. If you take an average across the industry the plants that are more energy efficient, which are predominantly the big ones, for example, Gladstone, Berrima, Railton, Birkenhead and Waurn Ponds, would be a bit better off than the smaller plants because they are more energy efficient. If you said, 'The average is 0.8', some of the bigger plants might come in at 0.74 or 0.76, so they would be slightly better off. But each company owns a big plant and a little plant, or a couple of big plants and a couple of little plants.
>
> Senator BUSHBY—If that reduces over time and you have to buy more carbon imports how will that play out, given that you have already exercised a lot of the efficiency measures and you do not have a lot more room in which to move?
>
> Mrs Bain—That really is the point. We do not have a lot more room in which to move. The technological changes that are required to get large CO2 savings have already been made. That low-hanging fruit has been picked.[116]However Professor Anthony Owen, of the Curtin University of Technology, explained that to offer credits or exemptions based on past action increases compliance costs and would make the scheme too bureaucratically burdensome. He further noted that industries who have

113 Mr Canion, CCI of Western Australia, *Committee Hansard*, 17 November 2008, p. 13.

114 Mr Peter Laver, Vice President and Fellow, Australian Academy of Technological Sciences and Engineering, *Committee Hansard*, 17 February 2009, p. 15.

115 Mrs Bain, Cement Industry Federation, *Committee Hansard*, 19 November 2008, p. 98.

116 Mrs Bain, Cement Industry Federation, *Committee Hansard*, 19 November 2008, pp 105-106.

> taken mitigation measures in the past benefited from their actions in various ways.[117]

3.128 The AAC noted previous actions taken to reduce the industry's carbon footprint have benefited the industry both financially and in terms of efficiency. However, as the industry in Australia is generally already operating at world's best practice, it is difficult to find further mitigation and efficiency opportunities, and that the technology to achieve further mitigation is not yet commercially viable, therefore impacting on the competitiveness of the Australian industry compared to nations that do not have carbon costs.[118]

3.129 The Department of Climate Change provided the following explanation when questioned by the committee:

> The proposed model for emissions-intensive trade-exposed assistance is to provide assistance on an industry average basis. To an extent an industry is below that average because of it [sic] past action or for other reasons, it will receive the same assistance as others in that industry.
>
> …
>
> If they are not trade exposed, they will face a lower obligation than other entities within their own industries when the scheme commences. So they will be entering the scheme commencement with a lower requirement to purchase emissions and will benefit in that way.
>
> …
>
> The liability is about how many permits you have to surrender. If you have to surrender less, your carbon costs are less than other firms in your industry. Even if those other firms have potential to come down to your level, while they are coming down they are surrendering more permits. The firms that are well placed will be well placed to [sic] relative to their competitors.[119]

Committee comment

3.130 The committee notes the lack of detail in the draft legislation regarding the support for EITE industries. The committee also notes the lack of accommodation of the extensive concerns raised with respect to the White Paper, particularly by trade exposed industries.

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117 Professor Anthony Owen, Professor of Energy Economics, Curtin University of Technology, *Committee Hansard*, 17 November 2008, p. 46.

118 Mr Ison, and Mr John Hannagan, Chairman, Rusal Australia, Member of the Australian Aluminium Council, *Committee Hansard*, 8 December 2008, p 37.

119 Mr Barry Sterland, First Assistant Secretary, Emissions Trading Division, Department of Climate Change, *Committee Hansard*, 19 November 2008, pp 82-83.

3.131 The committee considers that the government's rushed approach to the design, introduction and proposed implementation time table for the proposed CPRS is irresponsible and not in the public interest.

3.132 The committee considers that the design and level of complexity of any Australian emissions trading scheme should be consistent with what is happening in other relevant parts of the world.

3.133 The committee considers that the government should prioritise getting the design of any proposed emissions trading scheme right ahead of meeting any arbitrary and self-imposed deadlines.

3.134 The committee considers that proceeding with a badly designed scheme which puts pressure on the economy and jobs without achieving any discernable reduction in global greenhouse gas emissions will make the achievement of a 'global solution' less likely. The impact on the Australian economy and jobs of the current badly designed and flawed CPRS will discourage other jurisdictions from pursuing greenhouse gas reduction through emissions trading schemes in the future.

3.135 The committee notes the restrictions on mitigation measures as imposed by the Kyoto Protocol and advocates that Australia work to expand the Kyoto Protocol to include sequestration through soil carbon and the benefits of LNG and nuclear power in respect to global emissions.

3.136 The committee notes the concerns expressed regarding the potential inability of power generators to pass on the carbon price signal to consumers due to the regulation of retail electricity prices.

3.137 The committee notes that there is no renewable energy that can deliver reliable large scale base load power, that more research and assistance is needed for those renewable energies demonstrating most promise. The committee notes that there needs to be caution with respect to the RET so that we do not to make it harder to reduce emissions in the most cost effective way by imposing arbitrary targets.

3.138 The committee considers that the CPRS as currently designed does not achieve a sufficient environmental benefit and will not encourage investment in renewable technologies.

3.139 The committee agrees that the CPRS embodies a more ambitious and complex scheme than is in place or is being considered anywhere else in the world. The level of complexity is not something to be proud of. To the contrary.

3.140 The committee is of the view that the government's priority should be to design an appropriate scheme, not to get a scheme in place by an arbitrary deadline.

3.141 The committee considers the government needs to take further time to design an appropriate scheme for Australia, considering all possible alternative approaches.

3.142 The committee considers the further changes to the proposed CPRS announced by the Prime Minister on 4 May 2009 to be inevitable but very small steps in the right direction. The committee does not consider that the announced changes adequately address the fundamental flaws of the scheme as identified during this inquiry.

3.143 Specifically, the committee remains concerned that even after the changes announced by the Prime Minister:

(a) The proposed CPRS will be ineffective in reducing global greenhouse gas emissions;

(b) The government continues to 'fly blind' when it comes to the short and medium term impact of the proposed CPRS on the economy, jobs and regional Australia;

(c) Australia's trade exposed industries will continue to be disadvantaged under the proposed CPRS compared to their competitors (unlike in the much cited European Union emissions trading scheme);

(d) Many other flaws explored in some more detail in the remainder of this report have not been addressed.

Recommendation 5

3.144 The committee recommends that the CPRS as currently designed not be proceeded with.

Recommendation 6

3.145 The committee recommends that the Commonwealth Government commit to design a more appropriate scheme for Australia, which will be more effective in helping to reduce emissions globally and which will be more economically responsible.