AUSTRALIAN INDUSTRY GREENHOUSE NETWORK

26 September 2008

Committee Secretary
Senate Select Committee on Fuel and Energy
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

To whom it may concern.

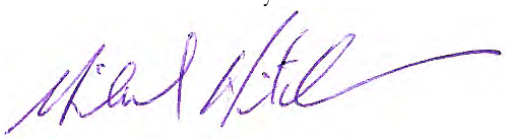
Senate Select Committee on Fuel and Energy Inquiry

The Senate Select Committee on Fuel and Energy has been established to inquire into a range of issues, in particular

> *d) the impact of an emissions trading scheme on the fuel and energy industry, including but not limited to:*
>
> *i. prices,*
>
> *ii. employment in the fuel and energy industries, and any related adverse impacts on regional centres reliant on these industries,*
>
> *iii. domestic energy supply,*
>
> *iv. and future investment in fuel and energy infrastructure;*

Although AIGN has not undertaken modelling of the impacts of an emission trading scheme, it has comprehensively addressed the potential impacts of design elements of the Australian Government's proposed emissions trading scheme in its Submission to the Carbon Pollution Reduction Scheme Green Paper. In responding to the Committee's terms of reference, AIGN attaches that submission for the Committee's consideration.

Yours sincerely



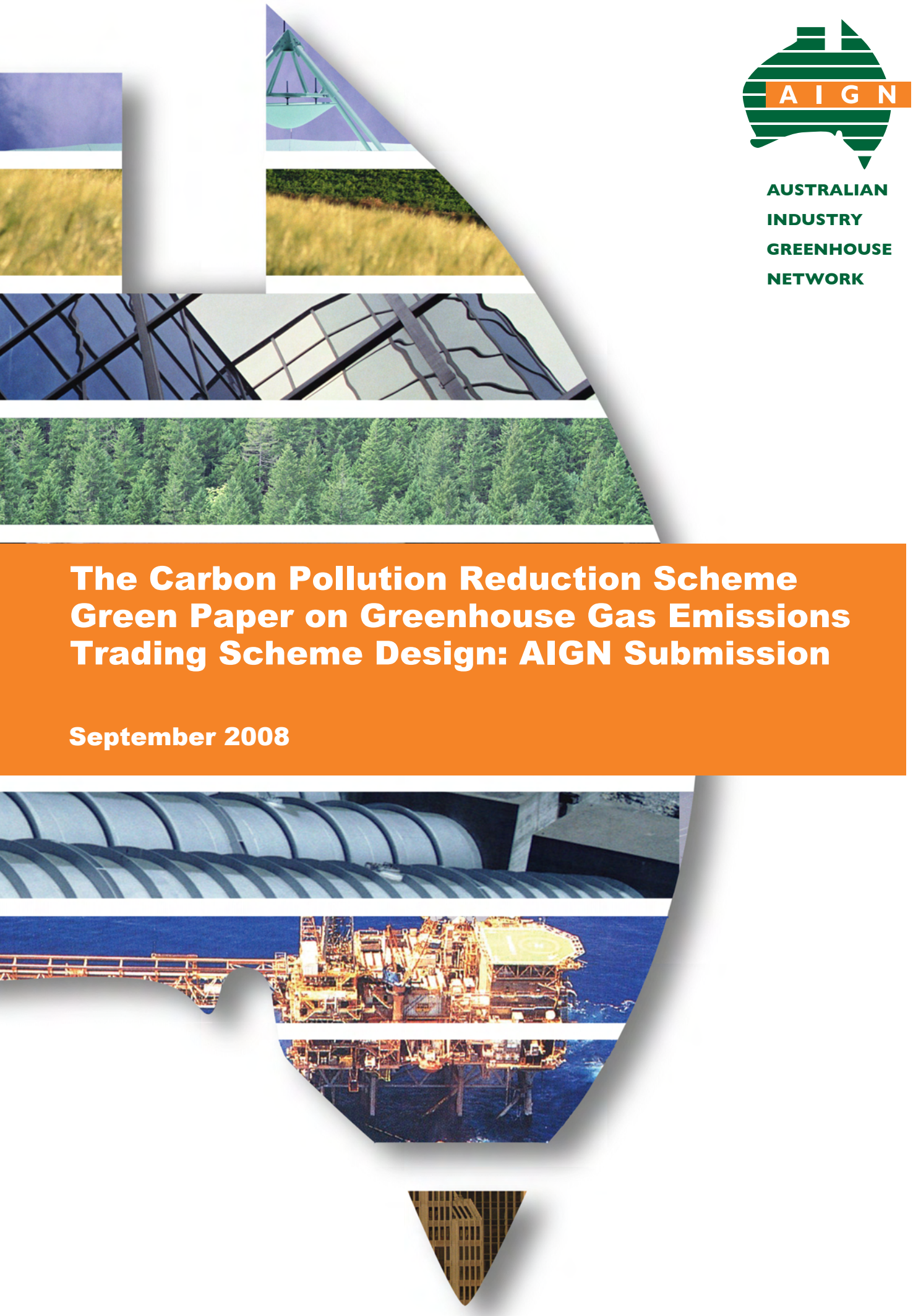
Michael Hitchens
Chief Executive Officer

Australian Industry
Greenhouse Network
ABN 93 108 941 117

Unit 3,
4 Kennedy St
Kingston ACT 2604

PO Box 4622
Kingston ACT 2604

T +61 2 6295 2166
F +61 2 6232 6075
E info@aign.net.au



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The Carbon Pollution Reduction Scheme Green Paper on Greenhouse Gas Emissions Trading Scheme Design: AIGN Submission

September 2008

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1 INTRODUCTION

The Australian Industry Greenhouse Network (AIGN) welcomes the opportunity to make a submission to the Government about the Green Paper on Emissions Trading Scheme (ETS) design.

AIGN is a network of Australian industry associations and businesses that have a serious interest in climate change issues and policies. A list of AIGN members is contained in Attachment A and AIGN's climate change policy principles are at Attachment B.

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

AIGN's response to the Green Paper is constrained by the absence of modelling of plausible global emission scenarios. AIGN's submission is in two parts:

- This main submission that follows the framework of the Green Paper and includes responses on matters sought by the Green Paper (Attachment C)
- A key messages submission.

In this submission, AIGN's responds to the proposed ETS model by broadly following the Chapter headings set out in the Green Paper. Before tackling those topics, however, AIGN believes it is important to set out what should be regarded as a successful Australian ETS.

2 ETS INDICATORS OF SUCCESS

It is important to recognise that the Green Paper ETS design is one that must deal with the period in which there is no comprehensive global agreement on emission reduction. In this context, and balancing economic efficiency, environmental effectiveness and equitable burden sharing objectives, AIGN contends that the key indicators of success for the ETS in this transition period will include:

- **Economic efficiency**
  - the least-cost permit price path begins at a modest level and increases over time following the marginal cost of abatement curve, which includes lower cost international abatement opportunities. This outcome has implications for design features associated with targets and trajectories, linking, and banking/borrowing
  - the permit price path reflects the availability of both supply and demand-side technologies to meet the abatement task. This outcome has implications for design features associated with targets and trajectories, and the support of RD&D
  - the ETS results in liquid secondary markets that reveal judgements about future permit prices, thereby allowing investors in long-lived assets and RD&D to manage risk. This outcome has implications for design features associated with permit allocation
  - a single permit price applies throughout the economy. This outcome has implications for design features associated with coverage and the abolition or phasing-out of Federal and State government measures additional to the ETS that impose costs on business
  - the permit price is reflected throughout the economy with no regulatory barriers to cost pass-through. This outcome has implications for effecting full energy market reform before an ETS can be economically efficient
  - Australia's trade exposed (TE) industries are not competitively disadvantaged both in terms of production from existing operations and investment in new projects. This outcome has implications for design features associated with permit allocation
  - delivery of RD&D technologies for the market at lower cost than we currently anticipate. This outcome has implications for how auction revenues are applied
  - the return to the community of revenues from permit auctioning in excess of those used to compensate low income households, as an offset to a general erosion of competitiveness in the economy, via a reduction in taxes on capital.
- **Environmental effectiveness**
  - Australia's actions demonstrably result in more nations adopting credible emission mitigation action. This outcome has implications for

matching domestic emission reduction targets and trajectories with Australia's international negotiating efforts
  - the emission reductions achieved in Australia are not dissipated by increased emissions in other countries. This outcome has implications for design features associated with permit allocation to offset the transitional loss of competitiveness of emission intensive trade exposed industries
  - acceptance of science based biological, geological and chemical sequestration. This outcome has implications for design features associated with coverage and linking.
- **Equitable burden sharing**
  - no-one, whether households, workers or shareholders, is required to carry a disproportionate share of the costs of mitigation. This outcome has implications for design features associated with the use of auction revenue to compensate low-income households, the design of the TE mechanism and assistance to strongly affected industry
  - aside from low-income households, which are disproportionately vulnerable, other Australians are prepared to pay for the higher cost of living in return for the benefits of the mitigation of climate change delivered by global emission reduction.

Overall, the success of the ETS might be measured in terms of how few negative unintended consequences arise, the degree to which Australia continues to be prosperous and the level of global emission reduction.

3 FRAMEWORK

The Green Paper's objectives for the ETS are to:
- meet Australia's emissions reduction targets in the most flexible and cost-effective way
- support an effective global response to climate change
- provide for transitional assistance for the most affected households and firms.

AIGN's objectives, set out in Section 2 above, encompass those of the Green Paper. A point of difference, however, is that transitional assistance for firms has been interpreted in the Green Paper for trade-exposed firms to be a form of permit allocation that would transition many operations out of the economy by 2020. In the context of a limited international agreement on global emission reduction, AIGN contends this is not consistent with Government policy (see Section 11).

AIGN's criteria for assessing design options for the ETS are economic efficiency, environmental effectiveness and equitable burden sharing. In respect to the Green Paper assessment criteria:
- AIGN notes that the environmental integrity criterion needs to be set in the context of the desired environmental outcomes being reductions in global emissions
- AIGN is concerned that the Green Paper often uses 'policy flexibility' and 'minimisation of implementation risk' to justify shifting of risk from government to liable parties at the expense of economic efficiency.

4 COVERAGE

4.1 Coverage

"Comprehensiveness" has long been an AIGN catch-cry – any regime that results in a price on emissions must encompass all GHGs, all sectors and sinks as well as sources (within administrative reason).

In this context, the AIGN strongly recommends the widest possible coverage of sectors, gases and sequestration (bio, geo and chemical) sinks from the beginning of the scheme so that the price of emissions is uniform across the economy. Where coverage is not possible or sensible, then alternative equivalent measures need to be implemented at the same time as the emissions trading scheme is adopted. Economic efficiency, fairness and environmental effectiveness require this outcome, not least because of the problem created by having to arbitrarily 'allocate' Australia's national budget among the ETS sectors and non-covered sectors.

This is not to say that the task is easy, far from it. However, even for sectors not suited to emissions trading, the task remains, as all sectors will need to contribute to the emission objective if that objective is to be met at least-cost.

In response to the Green Paper, AIGN:

- Rejects the effective exclusion from coverage of the use of liquid fuels for private transport until 2013, and perhaps beyond, as a distortion to the ETS which is not justified by any of the assessment criteria identified in the Green Paper
- Agrees with the proposed delay for inclusion of agriculture until 2015, and suggests that the legislation nominate this date. However, support is conditional on fair rules for the allocation of Australia's budget to the ETS relative to uncovered sectors, which should be included in the legislation in 2010
- With regard to the exclusion of deforestation from the ETS, AIGN is concerned that the notional allocation of permits for deforestation should be reduced to account for emission abatement opportunities through to 2020
- Agrees with the opt-in proposal for reforestation provided the rules do not allow gaming that would shift the burden of emissions onto government while credits are captured by landholders
- Agrees with the inclusion of coal mining, but only if the TE eligibility and allocation rules do not discriminate against export coal, and subject to the development of methodologies for fugitive emission estimation based on sound science
- Agrees that there is no need to create an 'offsets' regime for non-covered sectors, provided they become covered by 2015.

A key issue in the context of coverage is that liable parties will need up to 2 years advance knowledge of the measurement, acquittal and auditing rules to ensure adequate investment in, and testing of, technologies and systems to meet their legal compliance obligations. In all sectors there are companies that are not ready for emissions trading, and some cannot begin to be ready until the rules are known.

4.2 Point of liability

AIGN members have been working with the Department of Climate Change to establish an efficient and workable scheme of liability across all sectors having regard for the interests of suppliers and consumers.

The Green Paper preferred proposals generally reflect that work and are supported on that basis. However, there remains further detailed development of regulations to reflect those intentions in practice.

AIGN does not agree, however, with the use of NGERS reporting liability definitions for ETS acquittal liability. In summary, the ETS liabilities need to be aligned with the taxation law definitions of corporate liability.

5 CARBON MARKETS

AIGN supports the framework of strong property rights proposed in the Green Paper. This will have the effect of reducing risk premiums in derivative markets and lower the costs of managing risk.

It is important, however, to distinguish the nature of permits from that of derivatives for the purposes of financial regulation. AIGN suggests that anyone should be able to trade in permits, but dealing in derivatives needs to be regulated under the financial services legislation.

5.1 Banking and borrowing

AIGN recommends further investigation of the consequences of banking and borrowing on price formation.

AIGN is concerned that unlimited banking alone as proposed in the Green Paper (the Green Paper proposed inter-year make good provision is not effective borrowing) simply brings forward expected higher future permit prices to today, thereby levelling out the permit price path to an interest rate that does not reflect the likely slope of the marginal cost of abatement curve. That is, consumers, who have little control over permit trading, will pay more now (and expect to pay less later). Similarly, investors pursuing new technologies ready for market in say 20 years will face a lower future expected price that will delay commercial deployment.

Unlimited borrowing would seem likely to have the reverse impact, with a tendance for lower current prices and higher future prices, relative to the marginal cost of abatement curve.

AIGN has commissioned Professor Quentin Grafton of the ANU to look into the Green Paper proposals for banking and borrowing. Professor Grafton concludes that

the proposals in the Green Paper to limit borrowing will not deliver a least-cost price path for permits. Professor Grafton has made his submission to the Green Paper.

In summary, either there should be unlimited banking and borrowing, or neither – having one without the other, or one unlimited and one constrained, is likely to lead to distortions in the permit price path. Of course, neither domestic banking nor borrowing is relevant in Australian price formation if there is linking, since the permit price path is determined by international prices. It is important to recognise, however, that a higher international price will eventuate if the schemes adopted by other countries allow unlimited banking, but restrict borrowing.

Further, neither is appropriate if there is a price cap – for example, if there were a transitional price cap combined with banking, the incentive would be to bank now to take advantage of a future price and buy permits from the government at the capped price.

The Green Paper's main argument for banking is that it will smooth the permit price path over time. While this is undoubtedly the case, it will not address issues associated with daily price volatility – for example, AIGN understands that, for 2008, changes in the price of crude oil account for about 90% of the daily volatility in the EU permit price. Having the transport sector linked to the day to day fluctuations in crude oil prices is difficult enough for the economy let alone having an emissions permit price, which will affect all sectors of the economy, linked to that same volatility.

5.2 Caps and floors

The only design feature that AIGN has been able to identify to avoid unintended permit price trajectories is to set a 'safety valve' price cap trajectory with attendant implications for emissions. This may rule out linking with other countries that did not have the same price cap but would not rule out, say, the import of CERs under the CDM. A price cap trajectory could be abolished when the community had confidence in the maturity and stability of the domestic and international emissions markets. AIGN would support investigation of other instruments that could avoid unintended price trajectories.

The 'safety valve' price needs to be one that caps the economic impact that the community is prepared to accept for the Australian economy for an expected global environmental outcome. In this respect, the proposal in the Green Paper to set a price cap that is effectively a compliance penalty is unhelpful. A clear distinction needs to be made between a non-tax deductible compliance penalty, which is set to deter avoidance, and a tax deductible safety valve fee, which is set for the benefit of the whole economy with the expectation it will be used when necessary.

Notionally, provided the Government issues all the permits in a budget period (which is a necessary condition for least-cost as discussed above in banking/borrowing), the highest emission trajectory gateway adopted by government provides a floor price. AIGN supports such an implied floor price as it mitigates downside investment risk in long-lived lower emission technologies.

6 EMISSION TARGETS AND SCHEME CAPS

6.1 International negotiations and the ETS

AIGN supports the setting of Australian emission ETS budgets in concert with the international negotiation of a global agreement. The more transparent the government deliberations in linking national budgets to international negotiations, the better that uncertainty can be managed by investors with least-cost for the economy.

In the absence of more encouraging progress internationally, AIGN does not support the Green Paper's proposition that Australia's medium term emissions budgets and/or targets can be foreshadowed in December 2008 and legislated in 2009. AIGN submits that the legislating of the medium term budget to 2020 and gateways to at least 2030 can only be done in the context of the agreement reached in international negotiations. Of course, Australia should put forward emission budget proposals that help effect that international agreement.

One of the frustrations of the Green Paper is that it deals intellectually with emission trajectory design in the absence of plausible Australian trajectory scenarios linked to global scenarios. More disturbingly, it assumes that the only form of international agreement post-2012 will be

one that mimics the Kyoto Protocol architecture. In so doing, the debate on trajectories, and whether emissions from new TE projects should be accommodated in a national 'cap' or not, is divorced from a debate about Australia's negotiating options and the shape of a future credible global agreement. To continue to debate this matter in this way seriously limits options.

Rather, as AIGN's submission to the Joint Parliamentary Committee on Treaties examining ratification of the Kyoto Protocol suggests, Australia's negotiating options need to bring out into the open the issue of investment in projects developing globally traded emission intensive products. Australia is not the only nation struggling with this matter, and it seems unlikely that a durable international agreement can be achieved unless the concerned nations confront the issue. From Australia's point of view, and as the AIGN submission to the Treaties Committee suggests, two options that should be explored are to either negotiate an expanded 'assigned amount' for Australian TE's, the approach implicit in Australia's submission to the UNFCCC, or for relevant nations to agree to uniformly tax these projects as recommended by Prof Garnaut, adapting concepts advocated by Prof McKibbin.

Presumably there are also other options worth exploring that lead to Australia taking on a credible, equitable share of the international burden.

This aspect of international equitable burden sharing needs to be assessed in terms of relative economic impacts of measures adopted by countries, not simply in terms of nations announcing aspirational 'mine is bigger than yours' emission targets without proper regard to expected costs.

To illustrate the point about equitable burden sharing, AIGN observes, for example, that the current EU ETS covers just 40% of EU emissions and that the current EU permit price is some €24/tCO_2 (about A$40/t) in a wholesale electricity market of about €70/MWh – that is, the EU permit price has added about 20% to the wholesale electricity price. If permit price is a good proxy for economic impact, then an equitable equivalent Australian permit price would also add 20% to Australian wholesale electricity prices – currently, that would translate into about $10/t$CO_2$ (based on the average wholesale electricity price for NSW of $41/MWh in 2007-08 and raising it 20% to about $49.20/MWh assuming 85% cost pass-through).

6.2 Setting emission trajectories and gateways

AIGN supports an ETS that:

- Sets a 2050 aspiration target for Australia
- Establishes a transparent process for setting Australian emission budgets to 2050 that is reflective of the progress in international negotiations
- Commits materially to an emissions budget for Australia forward to 2020
  - a material commitment would involve the government issuing permits for the full firm budget period
  - the forward firm 10 years implies the international agreements should be pursued on at least a 10 year forward basis, not the shorter periods contemplated for the Protocol
  - the actual trajectory of emissions within the budget period would be determined by the market
- Sets upper and lower 'gateways' for a further 15 years
- Reviews, and rolls forward, the firm budget and gateways every 5 years, by 5 years.

The proposals in the Green Paper give 10 to 15 year budgets and gateways that are too short to support management of risk in 'bankable' investment, including investment in RD&D.

7 REPORTING AND COMPLIANCE

While NGERS is an adequate tool for reporting of emissions, it contains a number of weaknesses that mean it is not suited to performing a compliance role for an ETS.

Significant work has been done to standardise greenhouse emissions estimation and reporting through the development of the NGER. AIGN supports the use of NGER as the starting framework for emissions monitoring and assurance under the emissions trading scheme, as its goal is to streamline reporting into a consistent framework and therefore overcome duplication between the state and federal levels. AIGN is also broadly

supportive of the use of the emissions estimating methodologies available under NGER and acknowledges the need for staged increases in accuracy and minimum standards for specific emissions sources. However, NGER requires substantial detailed development and some modification to be used effectively. NGER currently contains requirements and processes that are impractical to implement and yet, in other areas is not sufficiently defined to ensure a level playing field amongst companies with permit liability. NGER will also require modification to allow for the differentiation of direct emissions from combustion of fuels purchased with or without a permit.

AIGN is also concerned with the use of NGERS reporting liability definitions for ETS acquittal liability. In summary, the ETS liabilities need to be aligned with the taxation law definitions of corporate liability. This means that the guiding rule for liability should be equity ownership of the operations rather than operational control.

AIGN agrees with the thrust of the compliance timeline in the Green Paper and that this needs to be matched with tax law to ensure no unintended tax liabilities.

8 LINKING THE SCHEME TO INTERNATIONAL MARKETS

8.1 International linkages

AIGN supports linkages that bring access to lower cost emission abatement opportunities. However, AIGN is concerned that linking, whether intentional or not, will occur and that Australia will import a price path from larger markets (for example, the EU) whether or not it is efficient and represents the best outcome for Australia.

In AIGN's view, if there is from the outset a high and unintended emission price in the Australian economy, with associated significant hardship for the community, the long-term credibility of the ETS will be destroyed. This has significant implications for using economic instruments in good policy making across government as a whole, not just in climate change policy.

Again, in the context of a limited international agreement, Australia should maintain control over its permit price so as to control the economic impact on the economy relative to the expected global environmental benefit. As evidenced in Section 6.1, the import of the EU permit price would impose a cost on Australia 4 times that imposed on European electricity consumers.

Contrary to the preferred position in the Green Paper, Australia should not restrict the import of emission reduction 'credits' that could lower the price of permits in Australia. Of course, at this point in time, it is not clear that the price of any Kyoto units would bring a lower emission permit price to Australia.

The Garnaut Draft report expresses the view that the CDM is likely to be a disincentive to major developing country emitters to take on early emission targets and budgets. While this may be the case, termination of the CDM after 2012 without any agreement from developing countries to take on targets and budgets effectively removes a key rational for linking – access to low cost abatement.

9 AUCTIONING OF AUSTRALIAN PERMITS

The key role of auctioning in an ETS is to deliver permits not administratively allocated into the market and thereafter, with minimum government interference, to allow the market to reallocate those permits to those that place highest value on them from time to time. However, this role is not simply related to this year's or next year's permits, it is also related to the full budget period and the period of gateways.

AIGN contends that permits dated up to 30 years into the future, and backed by strong property rights, need to be released into the market to promote the development of risk management tools for investment in long-lived assets, including investment in RD&D. If achieved, this has the practical economic efficiency outcome of reducing the risk premiums associated with such investments.

On the 'nuts and bolts' of auction design, AIGN supports features that:

- Deliver all the permits for a budget period into the market as soon as possible
- Where there are upstream acquittal liabilities, allow those liable to manage price volatility, working capital costs and debt
- Allow liable parties to quickly reflect the price of permits in their product prices where there are cost pass-through opportunities – in this respect regulatory cost pass-through restrictions in energy markets need to be removed before the ETS is live
- Are easy for all to understand
- Promote participation
- Maximise information to bidders
- Eliminate market manipulation opportunities.

9.1 Use of permit revenue

Auction revenues should be used to:

- Increase support for people on low incomes to offset the inflationary impact of the ETS
- Eliminate or reduce the most inefficient taxes in the economy
- Stimulate the initial deployment of 'first-of-kind' low emission technologies. However, the advent of auction revenues should not be used to justify the shifting of funding for low emission RD&D from general revenue
- Address genuine market failures where they remain and where financial incentives provide a least-cost solution.

Apart from the above mentioned uses for auction revenue, the proceeds from auctioning should not be used to subsidise any individual method of producing electric power (eg coal, nuclear, gas or renewables) nor energy efficiency or other low emission technology in the economy, excepting where there are clearly established ongoing non-price market failures, since the ETS itself will lead to a price on emissions and the attendant least-cost solutions.

10 HOUSEHOLD ASSISTANCE MEASURES

AIGN supports the use of auction revenues to fully offset the impact of the ETS on the living standards of low-income earners.

11 TRADE EXPOSED INDUSTRIES

AIGN supports administrative allocation of permits for existing operations and new investment in trade exposed (TE) industry, for as long as is necessary, to offset the distortionary erosion of competitiveness. In this context, the definition of trade-exposed industry is where the increased costs of emissions trading cannot be passed to consumers (or to upstream suppliers).

11.1 Defining trade exposed industry

The Green Paper proposition is that emission intensive trade exposed industry is a small proportion of the Australia economy.

Ignoring the indirect links to the rest of the economy – the links that continue to underpin the strength of the economy today – it is the case that these industries are a small direct contributor to GDP if the definition of tonnes/$million of revenue and a cut-off of 1500t/$million are used as proxies for defining emission intensive. Using these criteria, the Green Paper attributes a little over 4% of GDP using aggregated 2001 input-output tables.

However, as the BCA study[1] shows, because revenue is a poor proxy and the 1500t threshold not reflective of a material impact on firm competitiveness, it is possible that a significant proportion of trade exposed industry, representing around 20% of GDP and 45% of permits excluding agriculture (AIGN's estimate), may need to be assessed for a material impact. AIGN believes an administrative allocation scheme can efficiently assess this broader definition of trade exposed operations, that these operations can bear a fair share of costs and that the mechanism can be effective thereby ensuring that the costs borne by Australians will be in return for some environmental benefit.

Further, AIGN suggests that an assessment of the worth of trade exposed industry as simply its contribution to GDP or employment or any other single economic metric ignores the significant contributions these industries make

[1] *How emissions trading can work for the environment and the economy*, report by Port Jackson Partners to the BCA, August 2008.

to Australian society in general, and in some regions in particular.

11.2 Green Paper allocation

AIGN estimates that the Green Paper, excluding agriculture, proposes the following annual allocation of permits or auction revenues through to 2020:

- 10% to low income earners, as estimated by the Brotherhood of St Lawrence
- 15% in cent-for-cent transport fuels, until at least 2013
- 20% for trade exposed industry
- 10% for strongly affected industry.

That leaves 45% of permits unaccounted for in the Green Paper and more than 60% after 2013, and by 2020 over 70% of permits would be auctioned. Clearly, the unsubstantiated, arbitrary allocation of 20% of permits for TE industry can and must be increased.

AIGN's estimate is that TE industry could account for about 45% of the permits in 2010. This is compared with the current EU proposals that foreshadow about 40% of permits being allocated to trade exposed operations through to 2020 depending on the outcome of international negotiations (the remaining 60% of permits is to be auctioned). Further, trade exposed operations would be eligible to be allocated up to 100% of permits necessary to offset competitiveness loss[2].

11.3 The myth of burden shifting

The Green Paper asserts that permit allocation to TE industries increases the economic cost of the ETS, and shifts the burden of emission reduction costs to households and other sectors of the economy. Neither of these propositions is evidence based.

On the contrary:

- TE industries are those industries that are not able to pass the increased costs associated with the ETS to their customers. This means that households will not suffer increased costs for these products. It follows that every permit not allocated to TEs, but rather auctioned and the revenue used to compensate households, is in fact shifting burden toward TEs
- Correctly designed, the TE allocation does not inhibit pursuit by industry of low cost emission abatement opportunities and therefore no extra abatement needs to be taken by other sectors of the economy, including households
- The TE allocation proposed in the Green Paper will result in increased, economically inefficient abatement from the TE industries by reducing production and by deterring new investment in these industries. The result will be that households generally will be worse-off because of a decline in wealth in the economy, and shareholders and workers in these industries will be carrying an extra disproportionate burden
- The allocation of permits to TE industries will not change the price of permits in the economy, since the price of permits will either be set by a 'safety valve' or by an international price through linking.

The debate about burden shifting needs to be re-focused. It is the case that households should bear almost all costs of mitigation either in the form of:

- costs passed through by industry that is not trade exposed, which will be reflected in the increased cost of living for all households
- costs borne by those households who are also shareholders of industries that cannot pass on costs
- costs borne by those households who are workers in industries that cannot pass on costs
- costs borne by households in regional communities where industries that cannot pass on costs reside.

The principle of fairness should be that no household be asked to shoulder a disproportionate burden of mitigation cost, but as the above demonstrates, some households may potentially bear four avenues of cost unless the trade exposed (and strongly affected) industry mechanisms of the ETS are appropriately designed – and the Green Paper's proposals are demonstrably inadequate.

11.4 Green Paper proposals relative to the Government commitment

Labor's 2007 election platform, "Plan for a Stronger Resources Sector", states that:

"A Rudd Labor Government will

- Ensure that Australia's international competitiveness is not compromised by the introduction of emissions trading

[2]http://ec.europa.eu/environment/climat/emission/ets_post2012_en.htm

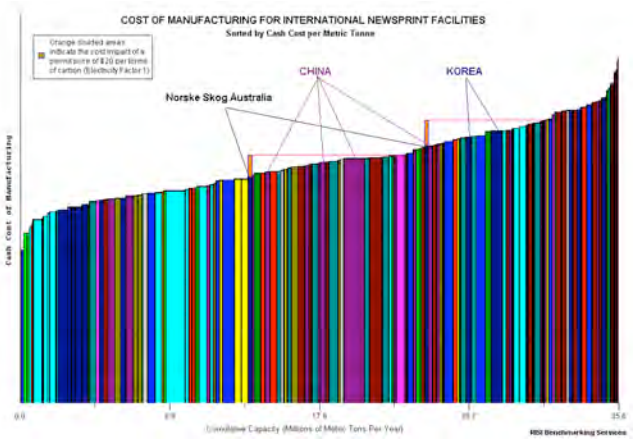
- Consult with industry about the potential impact of emissions trading on their operations to ensure they are not disadvantaged
- Establish specific mechanisms to ensure that Australian operations of emissions intensive trade exposed firms are not disadvantaged by emissions trading."

Labor's commitment to firms is that TE operations would not be competitively disadvantaged relative to operations in competitor countries that are without a similar price on greenhouse gas emissions. Best practice in this field of microeconomic, competitiveness analysis uses benchmarking of operating costs against direct competitors (see Figure 1 as an example in the newsprint industry, but every other trade exposed industry could provide similar analysis). In operations where feedstock costs are significant and determined by the market, the definition of competitiveness may be analysed in terms of benchmarking an operation's process costs, excluding feedstock, against direct competitors.

The case in Figure 1 shows the impact of a $20/tCO2 permit price with no mechanism to offset the competitive loss. The outcome is that the two Australian newsprint operations lose significant competitiveness to import competing operations:

- The first plant is shifted from being in the first quartile of internationally competitive operations to the last third of competitiveness
- The second plant is already in the second half of international competitiveness and is shifted into the bottom 15% of global operations.

Figure 1: International cost curve of newsprint mills



Labor's commitment is also for a 'no competitive disadvantage' mechanism that would apply for a transitional period of time. In contrast, the Green Paper describes a mechanism to rapidly transition industries to lower allocations of permits in a way unrelated to competitive disadvantage.

In short, the Green Paper proposals do not do the job:

- The arbitrary allocation of 20% of permits shifts the cost burden onto households associated with trade exposed operations that account for 45% of permits
- While there is nominally allowance for growth in trade exposed operations through the allocation formula, the 'decay' in the initial 90% and 60% assistance rates over time effectively mean there will be limited new investment in these industries
- Decay of allocation faster than technology options means forced structural adjustment
- Initial allocation at 90%, 60% and 0% creates inequities unrelated to the impact on competitiveness at arbitrary thresholds of 1500tCO_2/$ million and 2000tCO_2/$million of revenue
- The arbitrary differentiation of 90%, 60% and 0% allocation will distort inter-sectoral competition
- Anything less than a 100% offset of competitive loss doesn't do the job of ensuring no competitive disadvantage
- The allocation thresholds create 'early action' inter-sectoral inequity such that operations that have undertaken abatement activity prior to 2007/08 so that the industry average intensity, as a result, falls below the 1500t or 2000t have suffered a loss compared with activities that have done nothing
- Emissions per unit of revenue is the wrong criterion of eligibility or materiality as it is unrelated to cost competitiveness impacts and is distorted by commodity cycles
- The real issue relates to trade exposure and cost pass-through, and in this respect the Green Paper makes no contribution.

11.5 AIGN's proposal

AIGN's approach must be considered as a package – unpick one element and all elements need to be revisited.

- The share of permits allocated to trade exposed operations over the period to 2020 needs to be the amount that ensures no competitive disadvantage to existing operations and proposed new investment

- There is no need for an emissions intensity test, rather what is required is a trade exposure test, where trade exposure means no or limited opportunity to pass on costs as a result of the ETS. This is clear for all exports and most import competing operations, but requires some investigation for some import competing operations, perhaps by the Productivity Commission
- Trade exposed operations should receive 100% of scope 1 permits and 100% of permits needed to offset the increase in costs passed-through by non-trade exposed industry (typically in electricity prices including the impact of RET, gas prices and feedstock prices)
- Allocation to existing operations to be based on fixed relationships between output and scope 1 and indirect emissions measured in a typical recent year, as defined in the previous point. Allocation to greenfield and brownfield projects to be based on international best practice at the time. This provides an important incentive to drive efficient emission intensity reduction
- All allocation be in the form of permits, not cash.
- Allocation be estimated on a facility-by-facility basis and be linked to production much in the same way that the Green Paper sets out.

12 STRONGLY AFFECTED INDUSTRIES

The AIGN supports the administrative allocation of permits to compensate owners of strongly affected existing assets for the disproportionate loss in values that they will suffer from the introduction of the ETS. The disproportionate burden that these shareholders will bear in the absence of compensation arises because shareholders are also households, who will in any case shoulder the increase in energy and other costs in return for mitigation of climate change. Without compensation, these households will in effect pay twice. Auction revenue should be used to ensure workers and the communities associated with these assets are also assisted.

Compensation will also improve the economic efficiency of the ETS by countering any perceived increase in sovereign risk that investors might hold with the early introduction of an ETS in Australia.

The allocations could be for the remaining life of the asset that was expected before the ETS was implemented and the holder would be free to sell these permits even if the asset were closed down before that time. The allocation would be made once-and-for-all at the start of the ETS.

The estimation of expected disproportionate asset value loss would be based on the same modelling used to set Australia's budgets, targets and trajectories, and the same modelling used to compensate low income households and trade exposed industry for electricity cost pass-through. This modelling takes account of cost pass though, which is unrelated to historical emissions. The permit allocation would be calibrated to the estimated asset value loss in terms of both the value and the year of the expected loss. The actual allocation would equal the estimated asset value loss minus an average economy-wide loss, thereby defining the level of 'disproportion'.

In its many submissions to the NETS, the AETS and the Garnaut Review over the last 4 years, AIGN has not advocated an allocation of permits that bears any resemblance to the EU allocation scheme. The AIGN also notes that both the NETS and the AETS schemes accepted the thrust of the AIGN proposal as valid and feasible.

13 TAX AND ACCOUNTING ISSUES

AIGN has participated in workshops with Treasury and appreciates that there is recognition that the proposals in the Green Paper are not satisfactory. AIGN recommends that:

- Administratively allocated permits have zero value so that no unintended tax liability arises should they be acquitted in a following tax year, or banked and then sold
- Permits be zero rated for GST purposes
- States be dissuaded from imposing stamp duty on permit and derivative transactions.

14 TRANSITIONAL ISSUES

AIGN's submission to the Wilkins' Review (Attachment D) addresses these issues. In AIGN's view, the public good case for the support of RD&D is the only market

failure that would remain for business after the introduction of an ETS. There is no case for the expansion of MRET or the introduction of mandatory energy efficiency schemes that impose further costs on business.

If auction revenues are to be shared with States, then AIGN recommends that States should be tied to guarantees to immediately abolish or phase out:

- inefficient State taxes
- existing measures and not to introduce new policies, programs, and project approvals and licensing requirements that increase business costs.

Any failure by States would result in withdrawal of revenues.

15 GOVERNANCE ARRANGEMENTS AND IMPLEMENTATION

15.1 Institutions

AIGN supports the separation of policy roles, which is the province of governments, from market regulator roles.

Once the legislation is in place, the Green Paper proposes that Parliament will have the ability to disallow regulations which:

- Annually extend the 5 year fixed caps
- Every 5 years, extend the gateways
- Extend the coverage of the ETS
- Establish linking with other national or regional schemes
- Change measurement and other methodologies.

AIGN submits that, for all except the last dot point of matters, these important market-shaping issues should not be left to the unpredictability of Parliaments. AIGN proposes that the Act would set out the process and matters to be taken into account by the relevant Minister in deciding these issues and the nature of the directions the Minister might give to the regulator to implement the decisions. As identified earlier, AIGN recommends that the Act establish the dates for inclusion on non-covered sectors and, in the case of TE operations, the permits they would be allocated.

15.2 Compliance and penalties

AIGN supports a penalty regime that is consistent with other Federal corporate penalty regimes in Australia. AIGN notes again the difference between a compliance penalty needed to penalise those that are in default of the ETS and a 'safety valve' permit price intended to limit the impact on the economy for an expected global environmental outcome.

ATTACHMENT A: AIGN MEMBERSHIP

Industry Association Members

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

Individual Business Members

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

ATTACHMENT B: AIGN CLIMATE CHANGE POLICY PRINCIPLES

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

Australia should make an equitable contribution, in accordance with its differentiated responsibilities and respective capability[3], to global action to reduce greenhouse gas emissions and to adapt to impacts of climate change.

Australia should engage the international community in pursuing identified and beneficial environmental outcomes through greenhouse gas emissions reduction action which:

- allows for differentiated national approaches
- promotes international cooperation
- minimises the costs and distributes the burden equitably across the international community
- is comprehensive in its coverage of countries, greenhouse gases, sources and sinks
- recognises the economic and social circumstances and aspirations of all societies
- is underpinned by streamlined, efficient and effective administrative, reporting and compliance arrangements.

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

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

Australia's future greenhouse policy measures should:

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

[3] Australia's contribution to the global climate change effort as set out here reflects the principle in Article 3.1 of the United Nations Framework Convention on Climate Change. Differentiated responsibilities and respective capabilities could take account of such matters as a country's economic growth and structure, population growth, energy production and use etc.

ATTACHMENT C: RESPONSE ON MATTERS SOUGHT BY THE GREEN PAPER

FEEDBACK IS SOUGHT	AIGN COMMENT
1. FRAMEWORK	
2. COVERAGE	
Section 2.5.7 Netting-out arrangements: Stakeholder feedback is sought on netting out arrangements.	AIGN and its relevant member organisations have discussed the treatment of liquid transport fuels and gas within the scheme with the DCC and believes the Green Paper reflects those discussions. The netting out process should legislate for automatic acceptance by the regulator of approved documentation of an agreement between the user and the upstream supplier. This would include how to determine the liable party or when the liability is transferred from the default party to the new party, which need not require a year's notice in advance.
Section 2.8.1 Reforestation: Stakeholder feedback is sought on reporting and acquittal periods, accounting rules, thresholds and other design details.	AIGN understands that these issues are being progressed through a separate discussion paper with stakeholders, including A3P and NAFI, and supports these continuing discussions with the Government.
3. CARBON MARKETS	
Section 3.1.2 Efficient price discovery: The Government seeks specific feedback on whether the scheme regulator should publish the following information that would assist in the development of the permit market: • quantities and prices of carbon pollution permits auctioned by the regulator; • the quantity of free carbon pollution permits received by each entity and/or by industry sector; • total shortfalls in permits surrendered by liable entities; and • extent and nature of non-compliance with the scheme.	AIGN supports a scheme which delivers as much relevant information into the market place as possible in order to promote transparency and to inform the market operation. This includes a public registry of permits, which the Regulator would used to indicate who owns permits, and the quantities, as well as publication of non-compliance and shortfalls. AIGn agrees with publication of the four matters raised here.
Section 3.5.2 Form of the price cap: The Government seeks comment on the alternative forms that a price cap might take.	A 'safety valve' price cap needs to be one that caps the economic impact that the community is prepared to accept for the Australian economy. AIGN considers the proposal in the Green Paper to set a price cap that is effectively a compliance penalty to be unhelpful. There is a distinction between a non-tax deductible compliance penalty, which is set to deter avoidance, and a tax deductible safety valve fee, which is set for the benefit of the whole economy with the expectation it will be used when necessary. AIGN supports access to an unlimited store of permits that are 'above the emissions cap' sold by the Government at a fixed price.
4. EMISSIONS TARGETS AND SCHEME CAPS	
Section 4.4.2 Adjusting the cap for expansions in scheme coverage: The Government would announce an approach in early 2010 for expanding the cap to accommodate increases in scheme coverage that provided a smooth scheme price path. The Government seeks comment on the appropriate decision rule to facilitate this .	AIGN considers it critical that the Act, not subordiate regulations, set out which sectors, gases and sinks that are uncovered at scheme start; in which year they would become covered; and the amount of Australia's 'assigned amount' these sectors and gases would bring to the market when covered. These are not matters for uncertain application of decision rules.
Section 4.5 Scheme caps and gateway announcements: The Government seeks comment on the	AIGN supports an ETS that:

appropriate decision rule to facilitate this approach in the lead-up to 2010.	• Sets a 2050 aspiration target for Australia • Establishes a transparent process for setting Australian emission budgets to 2050 that is reflective of the progress in international negotiations • Sets a firm emissions budget for Australia forward to 2020 – this implies the international agreements should be pursued on at least a 10 year forward basis, not 5 years as is the case for the Protocol – the actual trajectory of emissions within the budget period would be determined by the market • Sets upper and lower 'gateways' for a further 15 years • Reviews, and rolls forward, the firm budget and gateways every 5 years, by 5 years. In this context, in the lead-up to 2010, Government should keep the community fully aware of the progress of international negotitations that are likely to set Australia's emission budget to 2020, and perhaps beyond, and the options that Australia has put forward in those negotiations. No 'decision rules' are needed other than to fully inform the community.m
5. REPORTING AND COMPLIANCE	
Position 5.4 Noting the four classes of methodologies available for NGERS, where Method 2 (see Box 5.1) or above is already in widespread use for a source, those methodologies would be imposed as the minimum to be used from the commencement of the scheme. The following sources would have minimum standards for emissions estimation methodologies imposed from the commencement of the scheme: • electricity sector emissions (as required for the National Greenhouse and Energy Reporting Scheme and the Generator Efficiency Standards program) • perfluorocarbon emissions (from aluminium production, as is current business practice and used for the National Greenhouse Accounts) • fugitive emissions from underground coal mines (as currently mandated by state safety regulations for the large majority of mines). Staged increases in the accuracy of emissions estimates over time would be pursued by imposing increasing minimum standards for estimation methodologies, where this is cost effective for the scheme overall. Additional sources would be investigated for the possible imposition of minimum standards for emissions estimation methodologies soon after the commencement of the scheme, but not in the first two years of the scheme. Sources that may warrant investigation include: • emissions from coal use (non-electricity, such as steel production) • waste sector emissions • natural gas combustion emissions (non-electricity) • fugitive emissions from open-cut coal mines. **Section 5.3.1 Monitoring: (Preferred option 5.4)** Comments are sought on these or other sectors that could be considered for higher order measurement methods following the commencement of the	AIGN is aware that officials are in discussions with the relevant sectors in advancing the methodologies for measuring emissions in these sectors. AIGN encourages the Government to continue to work with stakeholders to improve the relaiability of these methodologies. With respect to the Green Paper's preferred position that makes it mandatory for liable parties to have their returns audited by a third party prior to the lodgement date (Preferred position 5.10), AIGN does question how this will work in practice, given the short timeframes available for lodgement of returns, and the potentially limited availability of qualified assurers.

scheme.	
Position 5.9 A single report would be sufficient to satisfy an entity's obligations under both the National Greenhouse and Energy Reporting System and the Carbon Pollution Reduction Scheme, with reports to be submitted by 31 October each year. Emissions obligations under the scheme, the types of assessment methodologies used and any uncertainty estimates reported by liable entities would be published by the Government on the internet as soon as is feasible after reports are submitted. **Section 5.3.2 Reporting: (Preferred position 5.9)** The Government seeks feedback on whether the scheme should provide for the publication of reported information to the facility level.	The NGER Act allows for the public disclosure of corporate level greenhouse gas emissions and energy data. AIGN contends that this is appropriate – and that there is no need to amend the provisions for public disclosure to provide for the publication of facility level data. This issue has been extensively canvassed in the development of the NGERS Act. Business concerns about public disclosure revolve around the protection of commercially sensitive information and the presentation of data in proper context. Once the ETS begins there should be no need for the NGERS Act to apply the ETS liable parties. Information to be published by the Regulator related to ETS liabilites has already been discussed above in 3.1.2.
6. LINKING THE SCHEME TO INTERNATIONAL MARKETS	
Section 6.8 Providing clarity over linking rules: The Government seeks stakeholder input on how much notice should be given before qualitative restrictions are changed, including in a situation in which the environmental integrity of a particular type of international unit has been compromised.	AIGN contends that, as a matter of principle, any changes to the scheme's rules should have substantial notice, this applies to any changes to linking rules. In any event linking rules should be robust enough to provide confidence in schemes outside of Australia. AIGN would expect that a decision to link would only be made in the expectation that it would deliver lower permit prices in the Australian market. Disallowance of international units should take effect no earlier that the acquittal year following announcement of disallowance.
7. AUCTIONING OF AUSTRALIAN CARBON POLLUTION PERMITS	
Section 7.5.6 operational features of the auction: The Government seeks comment on the operational feature of the auction detailed in Box 7.8.	AIGN supports features that: • Deliver all the permits for a budget period into the market as soon as possible • Where there are upstream acquittal liabilities, allow those liable to manage price volatility and working capital and debt costs • Allow liable parties to quickly reflect the price of permits in their product prices where there are cost pass-through opportunities – in this respect regulatory cost pass-through restrictions in energy markets need to be removed before the ETS is live • Are easy for all to understand • Promote participation • Maximise information to bidders • Eliminate market manipulation opportunities. AIGN also supports the features in Box 7.8.
8. HOUSEHOLD ASSISTANCE MEASURES	
9. ASSISTANCE FOR EMISSIONS-INTENSIVE TRADE-EXPOSED INDUSTRIES	
Section 9.3.4 The process for determining eligible EITE activities: The Government seeks stakeholders' views on: • the proposed assessment process for establishing the emissions per unit of revenue for different production activities in the economy	With respect to this section, AIGN has expressed its strongly held view on the appropriate way to determine eligibility for consideration as a trade exposed industry in the body of this submission, making it clear that it considers the current proposals to be flawed in terms of economic efficiency, environmental effectiveness and fairness.

• the use of data from 2006–07 to 2007–08 to determine eligibility of production activities • the entity to which EITE assistance should be provided.	• Should an emission intensive eligibility criterion be retained then revenue is not supported as it is unrelated to competitiveness and distorted by commodity cycles. As proposed in the EU, all trade exposed operations should be eligible for alocation irrespective of emission intensity. This requires the share of permits to be around 45% in 2010. • AIGN considers the 2006-07 - 2007-08 to be an appropriate baseline for many operations but expects there will be many that will not have such data to determine an 'activity' baseline. Later data may be necessary. However, if a threshold of emissions intensity is retained then the appropriate baseline for the denominator needs to allow for the fact that some commodity cycles are experiencing record highs and that such data needs to be collected for a longer period. • The entity, or entities in proportion of equity, that own the operation.
Section 9.5.2 Establishing emissions-intensity and electricity-intensity baselines: The Government seeks stakeholder views on whether baselines for allocations should be based on emissions and output data over the period 2006–07 – 2007–08	AIGN considers the 2006-07 - 2007-08 to be the appropriate baseline – however it may be that the data does not exist for some activities/facilities and that the first verifiable date may come from the NGERs scheme. These baselines should only apply to exisitng operations. New operations would have baselines related to their actual technology.
Section 9.5.3 Electricity Factor: The Government seeks stakeholder views on the electricity factor to be used in calculating allocations for indirect electricity emissions and how it can be robustly and transparently calculated.	There are well established models of Australia's wholesale electricity markets, including those used by NEMCO and these should be used to estimate cost-pass through and the absolute level of impact of permit prices on wholesale electricity prices at a regional level. Other frameworks need to be used to estimate cost pass-through of other indirect emissions from other sectors not trade exposed (eg domestic gas). Any modeling results would need to be moderated by existing contractual arrangements. In relation to cogeneration and other off grid generation then the electricity factor should be the default electricity factor, ie the factor that would have applied if the consumer was purchasing its electricity off the grid.
Section 9.5.4 Measuring Output: The Government seeks stakeholder views on the approach for estimating the level of output used to calculate assistance to EITE entities.	Output should be estimates 5 years in advance, with annual true-up. The Regulator should have rules for adjustment of estimated output within the 5 year period along the lines of those used in provisional taxation.
Position 9.8 The emissions-intensive trade-exposed (EITE) assistance rate would be reduced over time with the intent that the share of assistance provided to the EITE sector does not increase significantly over time. **Section 9.6.1 Adjusting the level of allocations to EITE entities over time:** The Government welcomes stakeholder views on how the proposed EITE assistance rate should be adjusted over time.	The proposition that allocations to trade exposed operations should "decay" over time in the absence of similar constraints placed on international competitors is strongly contested by AIGN
10. ASSISTANCE FOR STRONGLY AFFECTED INDUSTRIES	
Section 10.2 Possible strongly affected industries: The Government seeks stakeholder feedback on whether any other industry might meet the proposed characteristics of strongly affected industries outlined in this chapter.	Dedictaed black coal mines to electricity generators are candidates.
Section 10.2.2 The Waste Industry: The Government seeks stakeholder feedback on competitive constraints and abatement opportunities in the waste industry.	AIGN has no views on the competitive constraints and abatement opportunities in the waste industry – and encourages further consultation with the industry.
Section 10.4.1 Energy security implications of assistance: The Government seeks stakeholder	AIGN suggests that these issues are best advanced through discussions with the Nartional Generators

• measures specific to the energy market • the medium-term national target range • direct assistance to coal-fired electricity generators.	
Section 10.5.2 Eligibility for assistance: The Government seeks stakeholder views on its proposed approach of giving the proposed direct assistance to the registered generator in the NEM or WEM in respect of particular generation asset, as of the day on which the proposed allocation of assistance is delivered.	AIGN suggests that these issues are best advanced through discussions with the affected stakeholders.
Section 10.5.4 A proposed simple asset-by-asset allocation method: The Government seeks stakeholder views on: • whether the relative proportion of the black coal and brown coal pools of assistance should be determined by estimating the relative impact of the scheme on these two asset classes using the broad results of a bottom-up electricity market modelling exercise • the appropriate definition of brown and black coal for the purposes of allocating direct assistance between assets in the two classes • whether it is appropriate to limit allocations of direct assistance to generation assets that are exclusively coal-fired.	AIGN suggests that these issues are best advanced through discussions with the affected stakeholders.
Allocation on the basis of capcity versus output: The Government seeks stakeholder views on whether it is appropriate to allocate direct assistance: • to assets on the basis of their capacity on the eligibility cut-off date • on the basis of 'nameplate' or 'sent out' capacity.	AIGN suggests that these issues are best advanced through discussions with the affected stakeholders.
10.5.5 The form of assistance: The Government seeks stakeholder feedback on the relative merits of providing direct assistance to coal-fired electricity generators through allocations of carbon pollution permits or cash permits.	AIGN considers that a once-and-for-all allocation of permits is the appropriate form of allocation, rather than cash payments.
10.5.5 Conditionality of assistance: The Government seeks stakeholder feedback on possible options for conditional support that would be consistent with the economic and environmental objectives of the scheme, and that would further the Electricity Sector Adjustment Scheme objective of ensuring security of energy supply.	AIGN suggests that these issues are best advanced through discussions with the affected stakeholders.
11. TAX AND ACCOUNTING ISSUES	
12. TRANSITIONAL ISSUES	
Section 12.4.2 Contractual impediments to carbon cost pass through: The Government seeks stakeholder views on the impacts of the scheme on commercial contractual arrangements	AIGN suggests that the ETS should not attempt to resolve contractual issues. It is the case however with respect to trade exposed and strongly affected industry that exisitng contracts may need to be taken into account when determining permit allocation.
13. GOVERNANCE ARRANGEMENTS AND IMPLEMENTATION	

ATTACHMENT D: AIGN SUBMISSION TO THE WILKINS STRATEGIC REVIEW OF THE AUSTRALIAN GOVERNMENT'S CLIMATE CHANGE PROGRAMS

1 INTRODUCTION

The Australian Industry Greenhouse Network (AIGN) welcomes the opportunity to make a submission to the Wilkins Strategic Review of the Australian Government's Climate Change Programs. AIGN makes this submission in the context of greenhouse gas emission reduction policies, programs and regulations (hereafter referred to as 'measures') that add to the costs of Australian industry.

AIGN is a network of Australian industry associations and businesses that have a serious interest in climate change issues and policies. A list of AIGN members is contained in Attachment A.

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

AIGN has previously made detailed submissions to Australian governments on the greenhouse and energy policy and regulatory environment, including participating in consultation processes concerned with 'Reducing the Burden'[4], and streamlining greenhouse and energy reporting. The objective of developing a coherent and streamlined set of climate change measures across jurisdictions (irrespective of the implementation of an emissions trading scheme) has long been requested by industry. In principle, this has been supported by Australian governments in successive iterations of a political commitment to a streamlining objective. However, in an overcrowded greenhouse and energy measures bandwagon – a recent audit by the Department of the Environment, Water, Heritage and the Arts has revealed over 140 Commonwealth and State (and Territory) measures – industry is yet to see any measure abolished and continues to witness the announcement of additional measures across jurisdictions with clearly no regard for co-ordination, national consistency or efficiency.

In this context, AIGN welcomes the strategic review of Commonwealth Government measures, and the intent for the review to develop principles and processes to assist in the assessment of what measures, if any, would be complementary to an emissions trading scheme. While recognising that the review is limited to Commonwealth measures, AIGN asserts that the measures of all jurisdictions are confusing and compromise the national framework required to meet the objective of reducing greenhouse gas emissions at least cost. Their existence is a critical consideration in understanding the measures required in addition to an emissions trading scheme and AIGN urges the Commonwealth Government to take a strong lead in pursuing this agenda with States.

AIGN advocates a competition policy style of agreement with States and Territories. The agreement would see revenues withheld by the Commonwealth Government where measures retained or introduced by States are not consistent with a national framework as determined by the Productivity Commission.

2 PRINCIPLES

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

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

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

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

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

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

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

AIGN recommends that, until transparent principles and processes are established to underpin the development of new measures, a moratorium on new measures be put in place. AIGN argues for this across all jurisdictions, however the Commonwealth should show leadership at a national level, by refraining from implementing new measures until the COAG process is finalised.

The definition of 'measures additional to emissions trading' should be broad and cover policies, programs and regulations that include as their objective the reporting or reduction of greenhouse gas emissions or energy, the latter as a proxy for emissions. In the case of regulations, this would include project approvals, and licensing processes and conditions. Specifically, and importantly, at the Commonwealth level, this includes any suggested amendment of the Environment Protection and Biodiversity Conservation Act (EPBC Act) to include a greenhouse "trigger".

3 MEASURES ADDITIONAL TO NATIONAL EMISSIONS TRADING

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

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

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

3.1 Market failures with emissions trading

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

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

- **RD&D** – a policy prescription is demanded that is effective in stimulating RD&D beyond that which would be delivered by the private sector alone. There is evidence that, because effective emissions trading schemes exist by government fiat only, the sovereign risk this entails in terms of government control of permit price inhibits a socially optimal level of investment in RD&D (see for example Montgomery and Smith[5]). AIGN suggests that a significantly expanded, public funded RD&D effort will be required;
- **Adopting frontier technologies** – AIGN's view is that any sensible pathway to future emission reduction targets will imply imposing on the economy a relatively low emission penalty initially, then rising steadily and predictably (although not with certainty) over time. This price pathway, while inducing the adoption of innovative technologies when they are commercial at the expected emissions price, will not induce early demonstration and adoption of these technologies much before that time. However, it is not yet clear that emissions trading design will achieve this sensible price pathway, particularly with the unpredictability around when major developing countries take on targets and the implications this will have for permit price. In this imperfect market, there will very probably be new projects across the economy that, if provided with a financial incentive, would be prepared to take on the additional risk of frontier technologies earlier than is commercially dictated by the emissions trading scheme. Governments may need to address this opportunity with financial incentives;
- **Energy market reform** – there remains work to be done on reforming Australian energy markets, including addressing related regulatory and taxation policies that inefficiently influence those markets. Unless all consumers are exposed fully to the energy cost ramifications of their activities, then the economic efficiency and environmental effectiveness of adding to those costs through an emissions trading scheme could be severely compromised. Governments should resolve these issues before implementing an emissions trading scheme;
- **Programs to inform the market** – it is very likely that an emissions trading market will take several years to mature. Not only will those liable to acquit permits need education in how to measure, monitor and verify their emissions, they will need education in the workings of auction markets and secondary markets. Further, although they are unlikely to be required to acquit permits, the general community needs to be informed about how permit prices translate into higher energy and other product prices, and the measures they can adopt to reduce their consumption.

3.2 Emission sources and sectors not covered by emissions trading

AIGN advocates inclusion of all gases, sources and sectors in the emissions trading scheme. Where there are exclusions at the beginning of the scheme, the legislation should identify a clear timetable for inclusion. AIGN expects that the emissions trading scheme will be comprehensive within just a few years of its beginning and consequently does not advocate additional measures associated with initial exclusion, including the creation of credits.

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

3.3 Measures in transition

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

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

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

3.3.1 Mandatory Renewable Energy Target

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

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

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

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

3.3.2 Greenhouse Challenge Plus

AIGN has been associated with the Greenhouse Challenge (now Greenhouse Challenge Plus) program since its inception and sits on the program's Industry Partnership Committee. AIGN members are active participants in Greenhouse Challenge Plus, which, amongst other things, is one of the ways by which energy use and GHG emissions are reported to government and reported publicly. In the absence of an emissions trading scheme, AIGN has been strongly supportive of the program, particularly as a voluntary program that enabled companies to demonstrate their abatement achievements, and builds capacity and awareness within their organisation with respect to reporting and verification of their emissions profile. It is worth recording that the scheme has developed considerable material in the form of reporting and auditing guidelines that are good starting points for the development of the systems and institutions that will be needed for a trading scheme. Industry has already devoted a very substantial amount of time and effort to developing these reporting methodologies, guidelines and rules.

Notwithstanding our long-term affiliation and support for the program, as a mandatory measure, Greenhouse Challenge Plus does not meet the principles outlined earlier and should be abolished. At a minimum AIGN considers it critical that the program's voluntary nature is reinstated.

Should the program be retained, Greenhouse Challenge Plus in its amended form has components that would need to be terminated. These include de-coupling the fuel-tax credit element from the program and abolishing the Generator Efficiency Standards program.

With the implementation of an emissions trading scheme, Greenhouse Challenge Plus would not be required by the bulk of AIGN members. Small and medium enterprises (SME's) may request a program that targets their specific needs and Greenhouse Challenge Plus might fit their requirements. However, this would require appropriate consultation with SMEs in order to properly ascertain the needs of this section of economy.

3.3.3 Energy Efficiency Opportunities

With an emissions trading scheme there will be no market failure case for mandatory energy-efficiency programs targeted at industry to address. Further, these measures become an unnecessary compliance burden, which distracts companies from directly focussing on their obligations under an emissions trading scheme. In that context the Energy Efficiency Opportunities program

should be terminated when the program reaches its first review period in 2011. The same result needs to be enforced for State based mandatory energy efficiency measures.

4 CONCLUSION

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

AIGN members are encouraged to hear that a priority task of COAG is to develop the principles for the rationalisation of measures that would not complement a national emissions trading scheme, to agree the level of government that should be responsible for any complementary measures and develop a plan of action for rationalisation.

The AIGN restates its recommendation that existing mandatory Commonwealth and State measures that overlap with and duplicate the national emissions trading scheme should be abolished or phased out. This includes not just programs, but also project approval regulations and licensing conditions relating to greenhouse gas emissions across all jurisdictions. Only those able to transparently demonstrate their 'value' through a rigorous analysis that identifies continuing market failure should be considered for retention.

AIGN believes it is vital that a binding agreement is struck between governments that ensures that redundant existing measures are removed or phased out, and that no new measures – including measures contemplated or currently under development across various jurisdictions – are adopted without assessment under the above framework. Indeed, it is recommended that any development work on new measures be frozen at this time.

A strong start to an intergovernmental agreement would be recognition that, because of the global nature of the emission reduction challenge, all measures should have national authority, although other levels of government may assist in implementation. A similar delineation of responsibility is required for adaptation action.