Business Council of Australia

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Submission to the

Department of Climate Change

on the

Exposure Draft Regulations to Establish the Emissions-Intensive, Trade-Exposed Assistance Program 2009

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Table of Contents

EXECUTIVE SUMMARY

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

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

The finalisation of legislation and regulations for the Carbon Pollution Reduction Scheme (CPRS) is occurring at a time of uncertainty about Australia's economic outlook.

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

INTRODUCTION

The Business Council of Australia (BCA) represents the chief executives of over 100 of Australia's leading companies. The BCA develops and advocates, on behalf of its members, public policy reform that positions Australia as a strong and vibrant economy and society. The businesses that the BCA members represent are amongst Australia's largest employers and represent a substantial share of Australia's domestic and export activity. Therefore, they have a significant interest in the scope and direction of economic reform.

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

Such an objective is not at odds with effective environmental management. It will require the introduction of policies which lead to environmental costs and risks being taken into account and addressed in the most efficient manner. In the case of greenhouse gas emissions and the risks associated with climate change, this can best be done through a market mechanism such as an emissions trading scheme.

However, the introduction of such reforms in the absence of a global response that includes Australia's competitor countries – and in the current economic climate – must be in a manner that does not disadvantage Australia's competiveness or put employment at risk, but rather in a manner that ensures a smooth long-term transition to a low-emissions economy.

This submission addresses a number of matters related to the draft regulations for the emissions-intensive, trade-exposed (EITE) industries elements of the Carbon Pollution Reduction Scheme.

It should be noted that a number of BCA members have made submissions addressing in more detail the specific issues and impacts of the regulations on their operations.

Commentary on the Exposure Draft

The BCA has undertaken extensive research and consultation with its members on the design of an emissions trading scheme and has highlighted a number of key concerns with the current legislation.

The challenges remaining are ensuring that the scheme detail is right and that the implementation of the CPRS, in the absence of a global price on emissions, is done in a manner that minimises the risks of economic shocks and unintended consequences such as job losses.

This requires careful consideration of the outstanding design issues for Australia's electricity sector, coal industry and emissions-intensive, trade-exposed industries.

There is a need to ensure the smooth transition of the electricity sector to low-emissions technology. There is also a need to recognise that coal-based generation will be part of the mix for the foreseeable future, both here and internationally. The final design of the CPRS must therefore provide coal-based generators with the capacity to supply electricity through the transition period and strong incentives for investment in low-emissions technologies in the sector, including the commercialisation of carbon capture and storage (CCS).

There remain major concerns with regard to the treatment of the coal industry under the CPRS. Coal has been excluded from the emissions-intensive, trade-exposed industry arrangements although it meets the threshold test. The plan to include fugitive emissions from coal mines in the CPRS when neither the EU nor the US is doing this has the potential to impact on the competitiveness of our coal exports. What remains essential is to establish arrangements that ensure the competiveness of this vitally important industry is sustained and jobs are not lost in the absence of a global approach to reducing greenhouse gas emissions.

Until such time as there is a consistent global price on emissions, recognition of the position of Australia's emissions-intensive, trade-exposed industries is essential to ensure the preservation of Australian jobs and to avoid 'carbon leakage', where emissions-intensive Australian industries simply move to other countries or where the

competitiveness of domestic producers is eroded leading to greater imports from non carbon - constrained countries.

The approach taken to EITE industries under the CPRS does not totally offset the impacts of the CPRS on the competiveness of these industries and the inclusion of an annual reduction in permits available to these industries i.e. the 1.3% annual decay rate is an additional impost on these industries which will already be purchasing at least 5.5% and 34% of permits subject to the activity definition.

In light of this the legislation should be amended to address the following matters:

Arrangements for emissions-intensive, trade exposed-industries

Until such time as there is a consistent global price on emissions, recognition of the position of Australia's emissions-intensive, trade-exposed industries (EITEs) is essential to ensure the preservation of Australian jobs and to avoid `carbon leakage', that is, where emissions-intensive Australian industries simply move to other countries or where the competitiveness of domestic producers is eroded leading to greater imports from non carbon - constrained countries.

The approach taken to EITE industries under the CPRS does not totally offset the impacts of the CPRS on the competiveness of these industries. The inclusion of an annual reduction in permits available to these industries i.e. the 1.3% annual decay rate is an additional impost on these industries which will already be purchasing at a minimum 5.5% and 34% of permits subject to the activity definition.

In light of this the legislation should be amended to address the following matters:

- Given the approach being taken in the US negotiations and the unclear outcomes of the international negotiations the CPRS legislation should specify that EITE arrangements will operate at least till 2020 and that permit allocation can only be varied following a public review post 2020 on an activity-by-activity basis and with five years notice.

- Greater clarity and specificity is required on the test to be used for the varying of EITE arrangements. What remains essential is that the test should be a measure of the carbon price faced by Australian business competitors. One approach would be to require the review panel undertaking the five yearly review to have evidence at the activity level that 80% of relevant international trade competitors have adopted emissions reduction measures that in effect impose a comparable emission price on the products produced by the activity before a five year notice period was given for the varying of the EITE arrangements for that activity.

- The definition of an activity should recognise that where a product requires a number of integrated sequential and parallel processes in order to be produced, all those processes are included in the definition of the activity. A review mechanism should also be included in the legislation and available where there is a disagreement on the activity definition.

- The BCA believes the decay rate poses an increasing burden on EITEs and if maintained it must be time-limited. The decay rate should be removed no later than five years after the commencement of the scheme. It is also essential to provide mechanisms for companies to seek a review and exemption from its application. These matters are discussed in detail later in this document.

- There are a number of businesses which are profitable and operate on low margins. It is recognised that the use of revenue in calculating their eligibility for EITE arrangements is not appropriate and the option to use value add has been provided. However there are a number of ways of measuring value add. A definition of value add should be included in the Act which recognises all input costs (including repairs and maintenance) as possible deductions from revenue for the purposes of calculating value add. One such definition is that of industry value add as used by the Australian Bureau of Statistics (noting that there may need to be some simplification to cover deductions of insignificant non-consumable expenses)

- It should be noted there are a number of design elements of the CPRS which will have significant detrimental impacts for specific EITE operations eg the electricity

allocation factor and the treatment of low-emissions demonstration plants. The BCA has not done detailed work on these matters in light of the analysis being undertaken by the directly affected companies.

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

MATTERS TO BE INCLUDED IN PART 8 OF THE CARBON POLLUTION REDUCTION SCHEME BILL

The BCA remains concerned that key policy matters related to the identification of EITE businesses and the operation of the EITE arrangements are not currently included in the Bill. A major implication of placing all such detail in the regulations is that key decisions by the minister and regulator cannot be appealed.

The BCA recommends that the following items are included in the Bill.

Determining Australia's emissions target	The Act should detail the public review mechanism to be used for any movement from the unconditional 5% reduction. Such a review should include assessment of global action and the actions of Australia's competitors (at the activity level) to identify whether there is comparable action which is measurable, reportable and verifiable. The review should also include reference to the share the national target that will be met through the CPRS and the uncovered sectors.
EITE Activity	The parameters for an EITE activity definition should be included in the Act. The definition of an activity should include all stages of a parallel or sequential activity

definition	ie where a product requires a number of integrated sequential and parallel processes in order to be produced, all those processes are included in the definition of the activity.
Review of activity definitions	An appeal mechanism should be included in the Act where a company can seek a review of the activity definition on the basis of the above parameters.
Fixed initial period of EITE arrangements prior to a review	The Act should include a clause which states that EITE arrangements will be in operation until 2020. The Act should also specify that the first review to determine whether EITE arrangements should be varied is after this date and that there should be five years notice of any variation to EITE arrangements.
Varying of EITE arrangements	The Act should include a specific test for the varying of EITE assistance. The purpose of such a test is to ensure there is an assessment at the activity level as to whether the competitors to the Australian businesses have an equivalent carbon price. One approach would be to require the panel undertaking the five yearly review to have evidence at the activity level that 80% of relevant international trade competitors have adopted emissions reduction measures that in effect impose a comparable emission price on the products produced by the activity. Subject to the outcomes of the review a five year notice period would be given for the varying of the EITE arrangements for that activity.
Notice period for varying of EITE arrangements	5 year notice period at a minimum must be given for the varying of EITE arrangements at the activity level.
Definition of value add for the purposes of calculating EITE arrangements	A definition of value add should be included in the Act which recognises all input costs as possible deductions from revenue for the purposes of calculating value add. One such definition is that of Industry Value Add (IVA) as used by the Australian Bureau of Statistics. We note that there may be a need for some technical simplifications to cover deductions of insignificant non-consumable expenses.

EITE arrangement thresholds	The Act should include the thresholds for EITE identification and the permit allocations for each threshold as well as methods for calculation. This section of the Act should be drafted in such a manner that precludes the exclusion of activities which meet the threshold criteria from EITE arrangements.
Decay rate	A time limit of 5 years should be set for any decay rate. The ongoing application of a decay rate, in the absence of a global carbon price, will make Australian businesses uncompetitive over time. Grounds on which a company (for an activity) can seek a review of or exemption from the decay rate prior to the commencement of the scheme or during the operation of the scheme should be specified in the Act. These could include: - where individual companies have already made the investments in: emission reducing technology the efficiencies to offset the decay rate may not be available; - where the technology or production process is as efficient as possible - where alternative technology investments are required to achieve emissions reduction and the decay rate impacts on the capacity to make the investment in a timely manner - where competitiveness will be increasingly affected the longer the decay factor applies.
Large electricity user contracts and reviews	The Bill should include a specific clause making clear the policy intention and the scope of the decisions the Authority must make in light of any review.

SPECIFIC MATTERS RELATED TO THE DRAFT REGULATIONS

ALLOCATIVE BASELINES FOR ACTIVITIES

The regulations do not provide the details of how the allocative baselines have been determined. The regulations should include the details of the estimations made.

DEFINING SIGNIFICANT EXPANSION IS CLAUSE 203

In discussion with BCA members across different industry sectors, the logic for use of the 20 per cent as a threshold for the defining of significant expansion is unclear. Such an arbitrary measure fails to recognise that depending on capital and other requirements companies will be absorbing substantial costs in the first year of the increasing production. An alternative approach would be to lower the threshold to 5 per cent.

SCOPE 3 EMISSIONS

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

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

REPORTING AND COMPLIANCE COSTS

The BCA notes that as the details of the CPRS are being incorporated in the various Bills and draft regulations, there is an increasing compliance and reporting burden on business. Little effort is being made to use established data collection approaches and processes which business must already comply with, and there appears to be little effort to ascertain whether the government and taxpayers are getting value for these additional costs on business.

Greater use of self-assessment approaches such as those used by the Australian Taxation Office with suitable penalties would reduce the compliance and cost burdens inherent in the CPRS.

BCA members with operations overseas have noted that in many instances Australia is imposing compliance arrangements more onerous than those in place in the EU ETS and being discussed in New Zealand.

An example of these concerns can be found in sections 1203, 1204 and 1205 which are at odds with the obligations on business under current continuous disclosure legislation.

CONTACT

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