Business Council of Australia

SUBMISSION

Price Floor for Australia's Carbon Pricing Mechanism

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Working to achieve economic, social and environmental goals that will benefit Australians now and into the future.

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About the BCA

Members of the Business Council of Australia are the chief executives of 100 of Australia's largest and most successful businesses. Through the BCA, they apply their skills and experience to develop, explain and promote policies for achieving economic, social and environmental goals that will benefit Australians now and into the future.

Our aspiration is for Australia to become the best place in the world in which to live, learn, work and do business.

1. INTRODUCTION

Australia's policy response to the risks associated with climate change should be workable, at lowest possible cost, fiscally responsible and not make Australian industries uncompetitive if competitor nations do not take equivalent actions.

It is only a strong economy with strong businesses that will have the capacity to invest in the technologies and process improvements to reduce emissions.

This submission considers the options proposed in the discussion paper *Price Floor for Australia's Carbon Pricing Mechanism.*

2. CONTEXT FOR THE BCA RESPONSE

The BCA remains of the view that:

- Restrictions should not have been placed on businesses' use of international permits to meet their full liabilities under the Clean Energy Act, including numbers of international permits and types of permits (subject to them complying with international standards).
- The Clean Energy Act should not include a floor price or a surrender charge. Both these elements will distort the market that is intended by the legislation and will bring additional costs to the economy and consumers at a time when all efforts should be directed at maintaining a strong and growing economy.
- The scheme should start with a low price in the fixed price period reflecting international prices while businesses and households adjust to this long-term policy. Should the floor price be maintained in the legislation, it too should be set to reflect the quantum of the international price.

3. DISCUSSION OF THE PROPOSAL

3.1 Objectives of the Clean Energy Act

The Clean Energy Act requires businesses that choose to use international permits to meet their liabilities to pay an additional surrender charge on top of the international permit price when the international price is lower than the floor price.

The *Price Floor for Australia's Carbon Pricing Mechanism* discussion paper outlines four different ways to implement the surrender charge.

The introduction of a surrender charge irrespective of the option used fails one of the key objectives of the Clean Energy Act, namely, that business be able to meet its obligations in a 'flexible and cost effective-way'.[1] For example:

- Companies will face a higher cost to meet their obligation where the surrender charge must be paid. Eligible international certified emission reduction units can be purchased for $7.00 per tonne (including carry forward costs); however, the application of the surrender charge will require the liable company to pay $15.00.
- Companies will seek to recover this additional cost where possible with the end result being a higher cost than necessary for households and the broader economy.
- Trading in international permits of itself is likely to have a higher cost under some of the options being proposed, that is, the institutions offering hedging and other products have suggested during departmental consultations that charges of between $1.40 and $4.00 per tonne could be required.
- Under Options 3 and 4 (which are premised on hedging against the level of the surrender charge) the cost of projects to generate certified emissions reduction units will increase and the incentive to invest in such projects will be reduced in response to the higher costs.

3.2 Assessment of the options

In assessing the options presented by the Department of Climate Change and Energy Efficiency, the BCA has given consideration to:

- the degree to which the option supports lowest cost for the liable businesses under the legislation
- the degree to which the option minimises market distortions
- the level of additional regulatory burden placed on business for the three-year operation of the floor price.

Summary of assessment

Should the implementation of a floor price be proceeded with, the BCA recommends further consultation be undertaken on Options 1 and 2, as they appear to have more potential to better fit the BCA assessment criteria. Both bring with them issues that need further elaboration before a preferred model could be identified.

The BCA recommends further consultations be undertaken on both these options.

The real risk of fraud under Option 1 needs to be assessed and details as to how the department would implement such an approach would be required before the administrative effort, systems changes and cost of compliance could be determined.

A key issue to be considered under Option 2 is how best to derive a suitable observed Australian market price that would not be burdensome for the regulator or liable entities.

Subject to more detail being provided, Option 4 may possibly meet the BCA assessment criteria.

Option 3 is not supported given it has the effect of inflating the costs to the economy and electricity consumers for the three-year floor price period.

3.2.1 Option 1: Setting a surrender charge based on the actual price paid for the unit

Option 1 potentially provides for lower-cost compliance with the legislation, minimises systems that have to be set up within the liable entity, and is potentially low-cost **subject** to there not being a requirement for every transaction to be audited through another process over and above the standard company financial and tax audits.

[1] Clean Energy Act 2011 3(c)(ii)

During consultations departmental staff have indicated this option is not supported, citing concerns that it may be open to fraud. The government has the capacity to bring into play the substantial anti-fraud provisions of the Act should they find a liable entity attempting to avoid the charge. The existence of this legislation of itself acts as a deterrent. It should also be recognised that the price paid for an international unit and related contracts are discoverable under both income tax law and ASIC law providing the capacity to identify possible fraud.

3.2.2 Option 2: setting a surrender charge based on the market price at the time the contract to purchase the units was entered into

Option 2 provides a more predictable price for liable entities, addresses the risks associated with investment in primary projects relative to trades in the secondary market, and is a workable mechanism for the determination of the transfer price.

A key issue to be considered under Option 2 is how best to derive a suitable observed Australian market price that would not be burdensome for the regulator or liable entities.

While the discussion paper has raised as a concern that this option will give preference to international permits over domestic permits, there is little likelihood of this. First, the legislation includes a clause that says the government at any time has the discretion to exclude classes of international permits with only a year's notice. Second, there is a limit on the number of international permits a liable entity can use. And third, there still remains the potential that the carbon pricing mechanism may be abolished with a change of government. All these factors will impact on liable entities' choice of permits.

3.2.3 Option 3: setting a surrender charge based on the market price at the time of surrender

Option 3, while offering a simpler administrative system and transparency, brings much greater risks and costs to liable entities who will want to know and lock in the total cost of their liability well before the time of surrender. The major drawback of this option is the difficulty in knowing with any predictability what the cost of the permit will be until it is surrendered. There will be a need to hedge each permit purchased so as to mitigate the cost and this means greater complexity and cost for the liable entity.

As indicated above, some financial institutions have indicated that costs could be between $1.50 and $4.00 per tonne to lock in the amount of the surrender charge at the time of an international permit trade.

This option has substantial potential to bring greater risks to the electricity market with flow-on cost impacts to electricity consumers. Were the charge to be $4.00 and 200 million international permits were purchased through to July 2018 as Treasury modelling estimates, the additional cost to liable entities would be $800 million. This will in turn flow through to the economy and electricity consumers.

3.2.4 Option 4: setting a surrender charge based on the market price at the time of surrender with the additional capacity for liable entities to enter into a legal undertaking with the regulator at a point in time for a particular price adjusted for the time value of money

At this stage it is not possible to fully assess the relative merits of this option. Without further information on what would be included in such a contract, the impact on liable entities remains unclear.

It does appear this option may result in the regulator in effect providing a hedging function and producing daily forward cost curves. Such a requirement would have substantial risks for the regulator and liable entity.

4. CONCLUSION

The BCA remains of the view that the Clean Energy Act should not include a floor price or a surrender charge. Both these elements will distort the market that is intended by the legislation and will bring additional costs to the economy and consumers at a time when all efforts should be directed at maintaining a strong and growing economy.

Should the implementation of a price floor be proceeded with, the BCA recommends further consultations be undertaken on Options 1 and 2.

The real risk of fraud under Option 1 needs to be assessed and details as to how the department would approach implementing such an approach would be required before the administrative effort, systems changes and cost of compliance could be determined.

A key issue to be considered under Option 2 is how best to derive a suitable observed Australian market price that would not be burdensome for the regulator or liable entities.

Option 3 is not supported given the additional cost this brings to both liable entities and the economy.

Option 4 cannot be fully assessed at this stage as insufficient detail on its operation is available.

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