MINERALS COUNCIL OF AUSTRALIA

SENATE ECONOMICS COMMITTEE INQUIRY

CARBON POLLUTION REDUCTION SCHEME BILL 2009 AND ASSOCIATED LEGISLATION

MARCH 2009

CARBON POLLUTION REDUCTION SCHEME BILL 2009: SUMMARY POINTS

- The proposed legislation contains fundamental flaws and must be substantially revised.
- If the proposed scheme is implemented in its current form, the competitiveness of the Australian economy will suffer, investment will stall, jobs will be lost and the overall environmental impact will be negligible, and possibly even negative.

Flaws in the design of the emissions trading scheme

The MCA has six fundamental concerns with the proposed scheme design outlined in the legislative package:

- The scheme design is not calibrated with progress toward a global agreement or the availability of low emissions technologies.
- It is out of step with other schemes being implemented globally, and will impose the world's highest carbon costs.
- It will threaten the loss of thousands of jobs and threaten billions of dollars of investment in Australia's minerals sector. Treasury modelling projects forecast coal mining output alone to fall by 35 per cent by 2020.
- The proposed price cap for emissions permits of $40 (increasing in real terms by 5 per cent p.a.) is too high and will not prevent damaging carbon price volatility.
- The proposed 2020 target, when combined with the flawed scheme design, will be very challenging; and
- the scheme will distort domestic economic activity by imposing different carbon costs on various sectors of the economy. The scheme design is excessively complex, will impose a high compliance burden, and contradicts broader Government efforts to simply regulation.

Flaws in the structure of the legislative package

The MCA has serious concerns with the *structure* of the legislative package including, but not limited to, the following:

- Critical elements of the scheme design – including the treatment of emission intensive trade exposed firms - will be dealt with in regulations rather than in the legislation proper. As a consequence:
  - EITE firms will lack policy certainty on the nature, detail or operation of the assistance program;
  - Parliament will not have the opportunity to directly scrutinise and/or amend the most critical elements of the scheme design; and
  - the complexity of the EITE assessment process means it will be unlikely that the Parliament (or affected firms) will have a clear indication of the operation and commercial impact when the legislative package is considered in May/June 2009.
- The legislation falls short of Government's pre-election commitments. The legislation's commitment to 'reduce the incentives' for firms to shift offshore is significantly weaker than the pre-election commitment to "ensure that Australia's international competitiveness is not compromised" by the introduction of emissions trading.
- There are numerous critical policy areas where existing detail is inadequate, further information is required, or where current drafting is unclear.

A simple alternative

- Many industry concerns with the proposed ETS design can be addressed with one change, namely a phased approach to the introduction of full auctioning of emissions permits.

OVERVIEW

The Minerals Council of Australia (MCA) represents Australia's exploration, mining and minerals processing industry, nationally and internationally, in its contribution to sustainable development and society. MCA member companies produce more than 85 per cent of Australia's annual minerals output, and will account for about 60 per cent of Australia's merchandise exports in the year to June 2009.

In the MCA's view, the proposed legislation should be assessed against simple policy imperatives.

To be economically and environmentally effective, an Australian emissions trading scheme (ETS) must be part of an integrated policy approach that includes the following:

- a global protocol involving greenhouse gas reduction commitments from all major emitters;
- the development and deployment of low emissions technologies; and
- a measured transition to an ETS, with cost burdens comparable with schemes or policy measures being developed by our international competitors.

The development and implementation of these policy tools must be closely synchronized.

If Australia implements a flawed ETS without progress on a global protocol or technology solutions, then there will be severe economic consequences.

Australia has both a responsibility and self-interest in taking a leadership role in the international climate change debate. The critical element of Australia's leadership role however will be the example it sets for others. If we act hastily and adopt a poorly designed ETS, the economic impact will be dire, and no-one will follow our lead. On the other hand, if Australia can demonstrate that it is possible to make the transition to a lower emissions economy without forsaking jobs, international competitiveness and living standards, then other nations will be much more likely to follow our example.

Assessment

The MCA considers that the proposed legislation to implement and govern the emissions trading scheme is fundamentally flawed, and must be substantially revised. If the scheme is implemented in its proposed form, the competitiveness of the Australian economy will suffer, investment will stall, jobs will be lost and the overall environmental impact will be negligible, and possibly even negative.

This submission has three parts, including a brief description of:

- the substantial flaws in the proposed scheme design;
- the minerals sector's concerns with the structure of the legislative package; and
- the simple alternative to the approach outlined in the legislative package, namely a phased approach to the full auctioning of emissions permits.

CONCERNS WITH SCHEME DESIGN

1. The scheme proposed in the legislative package is not calibrated with progress toward a global agreement or the availability of low emissions technologies.

- The proposed ETS will impose net carbon costs on the Australian business sector of $14.5 billion in the first two years, and nearly $34 billion over the first 4 years.
- The cost burdens imposed by the ETS are not comparable with, or linked to, actions by other major emitters, and take no account of the limited availability of low emissions technologies.
    - none of Australia's international competitors are likely to impose any carbon costs on their businesses or households over this period.
- This burden will be imposed on Australian business and householders irrespective of whether there is a global agreement achieved in Copenhagen in December 2009.
    - firm commitments from other major emitting nations – even developed nations – will take several years to emerge.
- By then Australian businesses will have paid tens of billions of dollars in carbon costs
    - the result will be lost jobs, investment and the long-term competitiveness of the Australian economy.

Absence of review mechanism

- Other nations are more closely calibrating their emissions reductions effort to progress in international negotiations. The European Union will review the design of the next phase of its own emissions trading scheme – which is not due to start until 2013 – after the Copenhagen meeting in December 2009. If the Copenhagen meeting fails, the EU will further adjust its scheme.
- In contrast, the White Paper scheme contains no such flexibility.

PROJECTED REVENUE FROM SALE OF PERMITS UNDER THE EMISSIONS TRADING SCHEME

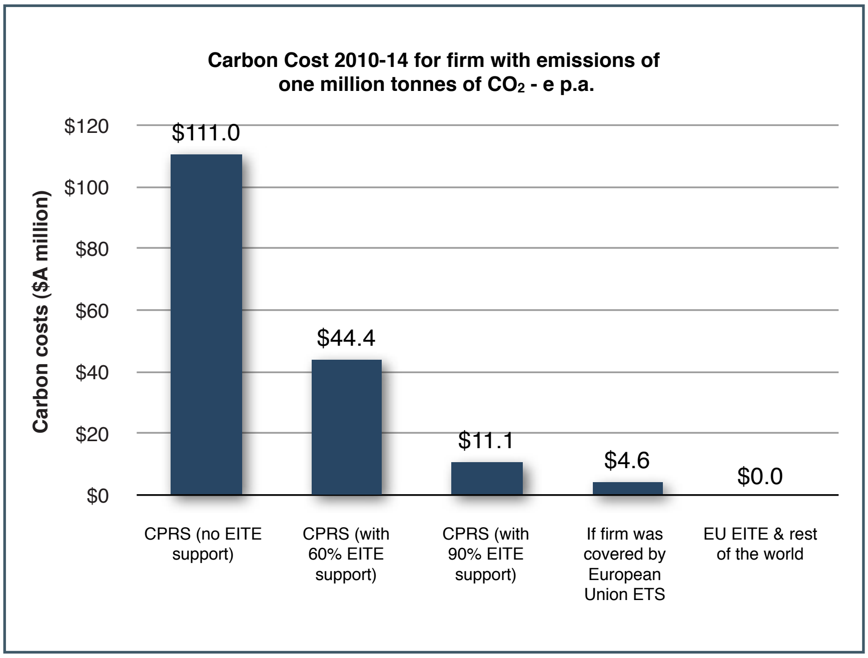
Year	No of permits auctioned.	Treasury's projected carbon price (per tonne of CO_2)	Revenue from sale of permits*	Net revenue after some free permits for EITE, transitional assistance for power generators, and other assistance.
2010-11	460 million	$25	$11.5 billion	$7.67billion
2011-12	454 million	$26.7	$12.1 billion	$8.17 billion
2012-13	448 million	$28.6	$12.8 billion	$8.67 billion
2013-14	442 million	$30.6	$13.5 billion	$9.17 billion
Revenue for years 2010-14			**$49.9 billion**	**$33.7 billion**

2. The proposed ETS is out of step with other international schemes and will impose the world's highest carbon costs.

- If the proposed ETS is implemented, Australian firms will pay the highest carbon costs in the world.
- All other international ETS schemes are based on a model where virtually all (more than 95 per cent) permits are allocated without charge during the transitional phase.
- In contrast, the proposed Australian ETS will auction around 70 per cent of total permits from the outset of the scheme.
  - this means that *most* Australian firms will buy 100% of their permits from July 2010. In comparison, their EU competitors will not have to buy all their permits until 2027.
- Even Australian firms classified as emissions intensive and trade exposed (EITE) will pay much more than their international competitors. Australian EITE firms will buy either 40 per cent or 10 per cent of their permits from 2010, a share increasing by 1.3 per cent every year.
  - by comparison, an EU firm classified as EITE will pay no carbon costs until 2020 at the earliest.

A simple case study highlights the high costs of the proposed ETS...

- An average Australian firm emitting 1 million tonnes of CO_2e per annum will face carbon costs of nearly $111 million over the 4 years 2010-14.
- Over the same period, an EU firm with the same emissions profile will pay less than $5 million. This reflects the fact that EU firms will receive virtually all their permits free until 2013, when they receive 80 per cent of their permits free.



3. The scheme poses a significant risk to jobs and investment in Australia's most competitive export sectors, including the minerals sector.

- The ETS will impose new costs on the Australian minerals sector of up to $2 billion a year.
- In its first 5 years alone, the ETS will cost the Australian coal and gold mining sectors $5 billion and $750 million respectively. Firms producing a range of other commodities including iron ore, uranium, copper and zinc ore, diamonds and silver will also pay hundreds of millions in permit costs over this period.
- None of our competitors will bear such a cost. Given the highly competitive nature of the global commodities markets, it is inevitable that the ETS will threaten jobs and investment in Australia's minerals sector.

The ETS will exacerbate job losses in the minerals sector

- Over recent months 10,700 jobs have been lost in the Australian minerals sector.
- The ETS will lead to further job losses. The Federal Government's own Treasury modelling forecasts that coal mining output will be slashed by between 33 and 35 per cent by 2020 as a result of the introduction of its Carbon Pollution Reduction Scheme (CPRS).[1]
  - separate industry modelling estimates that the ETS will slash output in other minerals sectors by a similar amount.
- A National Institute of Labour Studies report last year estimated that Australia's minerals sector would need to expand by 86,000 employees if Australia was to recover and maintain its global market share.[2] A 30-40 per cent reduction in projected output due to the ETS will mean that 30,000 to 35,000 of these jobs will be lost.
  - most of these jobs will be lost in regional and remote areas of Australia.

MOST MINERALS EXPORTS WILL RECEIVE NO ASSISTANCE UNDER THE WHITE PAPER MODEL

Minerals exports likely to receive some assistance under White Paper approach Aluminium, Alumina, Copper (refined), Zinc (refined), Refined lead and bullion, and Titanium.	**Value of exports 2008-9 (share of total)** **Approximately $16 billion (~11 per cent).**
Minerals exports likely to be exposed to the full carbon costs from the outset of the scheme, and ahead of international competitors. Thermal coal, Coking coal, Iron Ore, Gold, Lead Ores and concentrate, Uranium, Manganese Ore, Copper concentrate, Zinc ores and concentrate, Refined silver, Bauxite, Diamonds, salt and other minerals, Nickel, Zircon concentrate.	**Value of exports 2008-9 (share of total)** **Approximately $120 billion (~89 per cent).**

Source: ABARE.
Final determinations of EITE eligibility are yet to be made. The listing above is based on guidance contained in the White Paper. The minerals sector will be continuing to pursue EITE treatment for a number of the minerals commodities listed in the second row above.

[1] Australian Government, Australia's Low Pollution Future: The Economics of Climate Change Mitigation, October 2008. p.119
[2] National Institute of Labour Studies, The Labour Force Outlook in the Australian Minerals Sector 2008 to 2020, June 2008

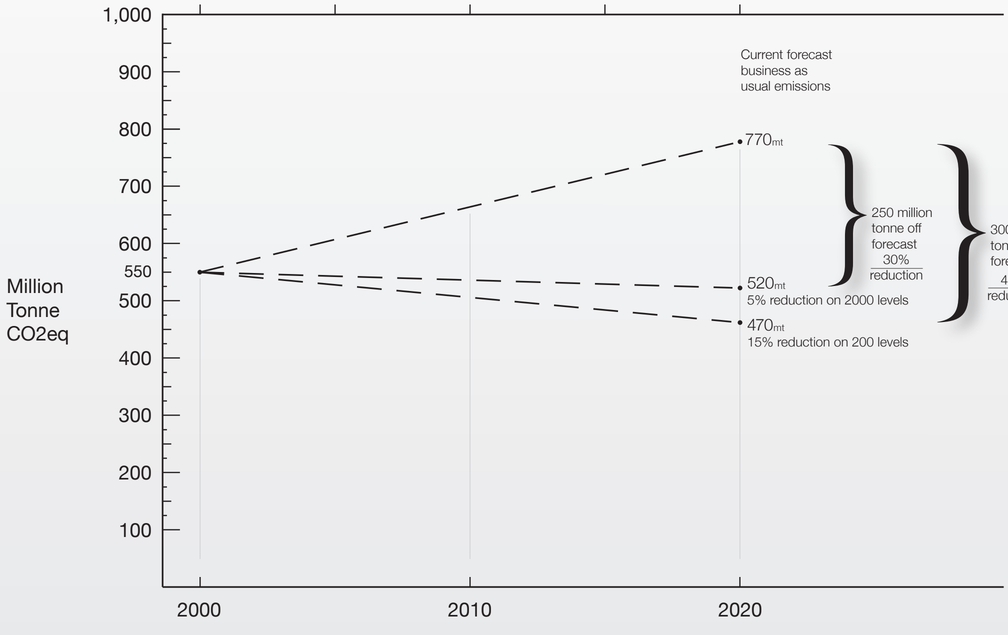
4. Proposed price cap of $40 (increasing in real terms by 5 per cent annually) is too high and will provide little assurance against damaging price peaks and volatility.

- There is a critical need for a moderate price cap - previous emissions trading schemes have shown considerable price volatility in their early stages
  - for example, the EU carbon price trebled in the first few months of its scheme.
- If the price cap was triggered in the early years of the scheme's operation, Australian business would be paying carbon costs of up to $20 billion annually.

5. The proposed interim (2020) target will be extremely challenging.

- A 5 per cent reduction in emissions (off 2000 levels) by 2020 represents a reduction of 250 million tonnes (or 32.5 per cent) of CO_2e off business-as-usual projections
  - it is nearly the equivalent to the emissions from Australia's entire electricity and transport emissions (275 million tonnes CO_2e in 2006).
- A 15 per cent cut represents a reduction of more than 300 million tonnes of CO_2e off business-as-usual projections
  - that is a 40 per cent reduction off business-as-usual projections.
- Calls for a 40 per cent cut are irresponsible and unachievable, and would represent an annual reduction of 440 million tonnes of CO_2e by 2020
  - That is nearly a 60 per cent reduction off business as usual projections.

Emissions Trading Scheme: Interim targets will be difficult.



Source: Treasury, Department of Climate Change.

6. The scheme contains unilateral and arbitrary exclusions, will impose different carbon costs on various sectors of the economy, and contains taxation provisions that raise a number of significant concerns.

Arbitrary exclusions from assistance under the scheme

- The scheme includes a notable, inexplicable and unsupportable exception to the eligibility criteria for assistance to EITE firms.
    - although the average emissions intensity of coal mining (conservatively estimated at 1400 to 1450t CO_2 per $million of revenue) prima facie qualifies for 60 per cent allocation of permits, the White Paper unilaterally states that "the Government will not provide EITE assistance to the activity of coal mining." [3]

The scheme will impose three different carbon costs on Australian industry

- The proposed scheme design risks creating significant distortions between and across industry sectors – competing products will be treated substantially differently, despite only minor variations in emissions intensity. With a putative $25 carbon price
    - firms with an Emissions Intensity (EI) above 2000t CO_2 per $million revenue, will pay $2.50 per tonne;
    - firms with an EI Between 1000t to 2000t CO_2 per $million revenue, will pay $10 per tonne; and
    - firms with an EI of up to 1000t CO_2 per $million revenue, will pay $25 per tonne.

The scheme design is unnecessarily complex

- The complex nature of the EITE rules contradicts the Government's broader commitment to simplify regulatory processes and taxation policy and administration, including through the Australia's future tax system review.

Taxation elements of the scheme raise several concerns

Initial analysis of the legislation has raised a number of concerns including:

- The proposed taxation arrangements are complex and potentially distortionary because they do not align with the legitimate corporate structures of the companies operating in the minerals sector.
- The application of GST to permits will create unnecessary administrative burdens on what are purely business-to-business and export transactions and place further cash-flow burdens on companies from the delays in reconciling GST credits in accounts.
- There is a real prospect that State and Territory governments will impose stamp duties on permits transaction-charges that could add millions of dollars to the cost borne by liable entities.
- The considerable costs involved in making application for and auditing of activities to obtain emissions intensive trade exposed (EITE) status under the Bill are not recognised as a legitimate business expense.

[3] Australian Government, *Carbon Pollution Scheme White Paper*, December 2008

FLAWS IN THE STRUCTURE OF THE LEGISLATIVE PACKAGE

The MCA has serious concerns with the structure of the legislative package including, but not limited to, the following:

Key details in regulation not legislation

- Critical elements of the scheme design – notably the treatment of emission intensive trade exposed firms (EITE) will be dealt with in regulations rather than in the legislation proper. For example, the legislation provides no substantive detail on the treatment of emissions intensive trade exposed firms, instead simply noting that the regulations 'may' formulate and EITE assistance program. This is a significant shortcoming of the legislative package for three reasons:
    - EITE firms will lack policy certainty on the nature, detail or operation of the assistance program;
    - Parliament will not have the opportunity to directly scrutinise and/or amend arguably the most critical elements of the scheme design; and
    - the complexity of the EITE assessment process means it will be unlikely that the Parliament (or affected firms) will have a clear indication of the operation and commercial impact when the legislative package is considered in May/June 2009.

Legislation appears to fall short of pre-election commitments

- The legislation falls short of Government's pre-election commitments, particularly in relation to the treatment of EITE firms.
- In particular, the objects clause of Part 8 of the CPRS legislation commits to 'reduce the incentives' for EITE activities to 'be located in or relocated to, foreign countries'.
    - this commitment is significantly weaker than the Government's pre-election undertakings which were:
        - "to ensure that Australia's international competitiveness is not compromised by the introduction of emissions trading," and
        - "to ensure that the Australian operations of EITE firms are not disadvantaged by emissions trading." [4]

Numerous areas lacking clarity

- There are numerous policy areas where existing detail is inadequate, further information is required, and where current drafting is unclear. These include, but are not limited to, the following:
    - the arrangements for major fuel users to assume the liability [from suppliers] for the resultant emissions;
    - the regulatory requirements relating to the treatment of emissions permits as 'financial instruments';
    - the CPRS legislation's interoperability' with the National Greenhouse Emissions Reporting Scheme (NGERS) is confusing and potentially duplicative.
        - In the absence of clarifications to the proposed 'operational control' arrangements, it is possible that one firm will be liable for certain emissions under the CPRS and another firm will be required to report the [same] emissions under the NGERs scheme.

[4] Senator Chris Evans, *Labor's Plan for a Stronger Resources Sector: Election 2007*, Australian Labor Party, 2007

A SIMPLE CHANGE – A PHASED APPROACH TO FULL AUCTIONING

Many industry concerns about the proposed emissions trading design could be addressed with one simple change – a phased approach to auctioning of permits for the trade exposed sector rather than 100 per cent of auctioning from the outset of the scheme.

It is an approach that would provide a measured transition to an emissions trading scheme. It would enable Australia to lead and shape the international debate while limiting the initial cost impact of the scheme on industry sectors and the broader economy.

Under a phased approach, all trade exposed firms would be required to purchase a proportion (10 per cent) of their permits in year 1 of a scheme, a proportion which could gradually increase as the scheme is bedded down and as other nations adopt binding emissions reductions. Under this approach there would be no arbitrary emissions intensity thresholds or complicated formulae for determining eligibility.

Such an approach would have the following advantages:

- It would be consistent with other approaches being implemented or planned in other nations including the European Union, United States and Canada, and New Zealand;
  - under the EU scheme, permits will be allocated free for the first 8 years (till 2013) when firms will buy 20 per cent of permits; and
  - under the Western Climate Initiative involving 7 US States and 4 Canadian provinces, permits will be allocated free until 2015, when firms will be invited to buy 10 per cent of their permits.
- a phased approach will not weaken the environmental credentials of the scheme.
  - As the respected Pew Centre on Global Climate Change has indicated, "because total emissions are capped, the allocation of allowances does not affect the environmental integrity of a cap and trade scheme". [5]
- There would be no need for arbitrary thresholds, and no distorting impacts on economic activity – the burden of the new scheme would be spread evenly across the economy.
- It would enable better alignment with the other key policy pillars – a comprehensive global protocol and the development and demonstration of low emissions technologies.

A phased approach to auctioning eliminates inter-sectoral distortions. All trade-exposed sectors would pay the same price for a tonne of CO_2 emitted. Such an approach contrasts with the approach set out in the legislative package, which will impose three different carbon costs.

[5] Pew Centre on Global Climate Change, 'Greenhouse Gas Emissions Allowance Allocation', Congressional policy Brief, 2008

ATTACHMENT 1 : EMISSIONS TRADING SCHEMES AROUND THE WORLD

Country/Scheme	Share of auctioned permits
US Acid Rain Scheme	Virtually all **(98.75 per cent) of permits issued free**.
European Union ETS (2005-2013)	About **98 per cent of permits issued free**.[6]
European Union (2013-2020)	More **limited coverage** in both sectors and greenhouse gases than Australian scheme. From 2013 onwards, **non-power sector firms will buy only 20 per cent of their permits.** This share will increase to 70 per cent by 2020. **Average EU firms won't buy 100 per cent of their permits until 2027** (17 years after their Australian counterparts).[7] EU firms which are classified as emissions-intensive and trade-exposed will receive their permits free until 2020.
Australia	**25 per cent of permits issued free** to selected non-farm EITE industries. **All other firms will buy all of their permits from 2010.**
New Zealand	**100 per cent of permits issued free** until 2018-19.
United States	**Schemes underway at the regional level** **The (US) Western Climate Initiative:** (A cap and trade scheme involving 7 US states and 4 Canadian provinces) will adopt a phased approach to auctioning, commencing with 10 per cent auctioning (including for the power sector) in 2012. **Numerous Congressional proposals – virtually all to date have proposed phased approach** to auctioning. The Boxer Lieberman Warner Bill (defeated in 2008) proposed **75.5 per cent of permits issued free,** with reduction of free permits to 40 per cent by 2032. From **2032 to 2050, 40 per cent of permits would have been issued free.** S.1766, sponsored by Chairman of the Senate Energy and Natural Resources Committee Senator Jeff Bingaman, proposed that auctioning be phased in from **24 per cent from 2012–17, rising to 53 per cent in 2030.**

[6] In Phase 1 of the EU ETS, only 4 of 25 EU nations auctioned any permits, and only Denmark auctioned 5 per cent of its permits.
[7] See Council of the European Union, Energy and Climate Change – Elements of the Final Compromise, Document 17215/08, Brussels, 12 December 2008.

THE EMISSIONS TRADING SCHEME AND THE AUSTRALIAN MINERALS SECTOR

Minerals Council of Australia

How will the ETS affect the minerals sector?

The ETS will impose new costs on the Australian minerals sector of up to $2 billion a year.

In its first 5 years, the ETS will cost the Australian coal and gold mining sectors $5 billion and $750 million respectively. Companies in other mining sectors will also pay hundreds of millions of dollars over this period.

None of our competitors will bear such a cost. Given the highly competitive nature of the global commodities markets, it is inevitable that the ETS will threaten jobs and investment in Australia's minerals sector.

What impact will that have on jobs in the minerals sector?

Over recent months 10,700 jobs have been lost in the Australian minerals sector.

The ETS will lead to further job losses. According to Treasury modelling and industry estimates, the ETS will reduce forecast output in the coal and other mining sectors by 30 to 40 per cent by 2020.

A National Institute of Labour Studies report last year estimated that Australia's minerals sector would need to expand by 86,000 employees if Australia was to maintain its market share. A 30-40 per cent reduction in projected output due to the ETS will mean that 30,000 to 34,000 of these jobs will be lost.

Most of these jobs will be lost in rural and regional areas of Australia.

Doesn't the proposed ETS include a compensation package to enable a transition to the new scheme?

The overwhelming majority of Australian minerals exports will receive **no assistance** under the Government's so-called Emissions Intensive Trade Exposed (EITE) program. In its current form, less than 10 per cent of minerals exports will receive any support.

Australian minerals exports worth around $120 billion in 2008-09 will face the full impact of the world's highest cost ETS. That means that firms responsible for around 90 per cent of Australia's minerals exports will pay billions of dollars in permit costs many years before any of their competitors.

Even firms that do receive some assistance will pay more than their competitors. Under Government proposals these firms will pay for between 10 and 40 per cent of their permits. If these firms were located in the European Union, they would pay no carbon costs for the next 12 years at least.

The coal sector has been explicitly excluded from receiving a share of allocated permits, even though it qualifies for support under the scheme.

What will the impact be on the coal mining sector over the short and medium term?

The scheme will impose new costs on Australia's black coal sector of $5 billion over the first 5 years (see box on page 2).

The Federal Government's own Treasury modelling forecasts that coal mining output will be slashed by between 33 and 35 per cent by 2020 as a result of the introduction of the ETS. [1]

[1] Australian Government, *Australia's Low Pollution Future: The Economics of Climate Change Mitigation*, October 2008. p.119

THE EMISSIONS TRADING SCHEME AND THE AUSTRALIAN MINERALS SECTOR

Minerals Council of Australia

COST TO THE BLACK COAL INDUSTRY FROM 2010-15

Year	Emissions ($MtCO_2$-e)* (Direct and indirect)	Carbon Price**	Cost
2010–11	34	$25	$875 m
2011–12	34	$26.7	$907.8
2012–13	34	$28.6	$972.4 m
2013–14	34	$30.6	$1.04bn
2014–15	34	$32.7	$1.1 bn
Five year cost			**$4.9 billion**

*Based on direct and indirect emissions from the black coal sector in 2006-7.
**Carbon price based on CPRS White Paper starting at $25 increasing by 4 per cent in real terms p.a.

What other nations have imposed carbon costs on their coal or minerals sectors?

None.

The European Union has exempted methane (the greenhouse gas generated during the extraction of coal) from its emissions trading scheme. Coal producers in Europe will face no carbon costs for at least the next decade - 58 coal mines have re-opened in the United Kingdom in the last year.

There is <u>no</u> prospect of coal producers in Indonesia, South Africa and Colombia facing any carbon costs over the next decade or two.

What about the Government's plan to provide $750 million over 5 years to the coal sector to ease the transition to support the transition?

This support represents only a small fraction of the costs that the ETS will impose on the coal sector.

Over the same period, the coal sector will pay about $5 billion in permit costs. In other words, the coal sector will pay the Government $7 for every $1 that it receives in assistance.

Is the minerals sector arguing that the Government should do nothing?

Not at all.

The minerals sector has put forward a simple change to the proposed ETS, namely a phased approach to the auctioning of permits. This approach would enable Australia to lead and shape the international debate while limiting the initial cost impact of the scheme on industry sectors and the broader economy.

This approach would be similar to the approaches being adopted around the world – in Europe, the United States and New Zealand.

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