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The Secretary
Senate Standing Committee on Economics
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Sir,

SUBMISSION TO THE COMMITTEE ON THE EXPOSURE DRAFT OF THE LEGISLATION TO IMPLEMENT THE CARBON POLLUTION REDUCTION SCHEME (CPRS)

Part 1: Introduction

1. This submission is made by Robert Pritchard, managing director of ResourcesLaw International (ResourcesLaw). ResourcesLaw is a Sydney-based energy policy consultancy, established in 1988.
2. In 1982, I was the Founding Chairman of the International Bar Association Section on Energy and Resources Law. In 1996, I edited the IBA book "Economic Development, Foreign Investment and the Law".
3. I have 40 years' experience as an adviser to government and private sector clients in many facets of the energy industry and the carbon markets. Over the last five years, ResourcesLaw has undertaken consultancies for the Asia-Pacific Economic Cooperation (APEC) Energy Working Group on energy security, energy industry reform and cross border trade in natural gas and LNG.

4. I wish to disclose the undermentioned affiliations:

*APEC Gas Forum – Technical Director
Australian Energy Alliance – Treasurer
Australian Institute of Energy – Fellow
Australian Institute of International Affairs – NSW Vice-President
CSIRO Energy Transformed Flagship – Member of Advisory Committee
Piper Alderman Lawyers – Consultant
University of Dundee – Member of External Faculty, Centre for Energy Petroleum and Mineral Law and Policy
WEC Australia Ltd – Director
World Energy Council – Member of the WEC Cleaner Fossil Fuel Systems Committee and the WEC Task Force on Rules of Global Energy Trade*

5. I do not wish to controvert in any way the conclusions of the Fourth Assessment Report of the Intergovernmental Panel on Climate Change (IPCC), published in 2007, which concluded that climate change is due to anthropogenic causes and recommended that greenhouse gases be reduced to at least 450 ppm by 2030.
6. Since June 2006, ResourcesLaw has raised the question whether it is already too late for the global community to combat climate change in the time frame hoped for by the UNFCCC (see the **attached** Recent Developments Bulletin). Much damage may have already been done by climate change. From the various reports we have studied, it would appear that the global climate system simply cannot be readily susceptible to regulation by the manipulation of only one variable, that is, by the reduction of GHG emissions. This conclusion is consistent with the conclusions of IPCC Working Group III referred to in Part 3 of this submission.
7. In our submission to the Task Group on Emissions Trading in March 2007 and subsequently, we have consistently advocated that Australia should proceed with a domestic emissions trading scheme of its own but only if the scheme were designed not to damage Australia's international competitiveness.
8. On 27 February 2009, the Minister for Climate Change and Water, Senator Penny Wong, announced that she had written to the Senate proposing that the exposure draft be referred to your Committee. According to the Minister, *"The purpose of the exposure draft legislation is to enable consultation on the terms of the Bill and its effectiveness in delivering the White Paper's policy decisions."*
9. This submission attempts to examine the Bill's effectiveness in delivering the Government's policy decisions but, at the outset, I emphasise the impossibility of conducting such an examination with any expediency given that the 820-page White Paper:
 - (a) contains 193 specific policy decisions;
 - (b) enunciates three policy pillars that are not in complete concord, namely (1) a domestic mitigation strategy; (2) adaptation to climate change that we cannot avoid and (3) helping to shape a global solution; and
 - (c) is noteworthy for two interlinked policy decisions which make the Committee's task almost impossible, one that embodies a commitment to be "cost-effective" (Policy Decision 5.1) and another that allows imported units to count towards national targets (Policy Decision 11.1)

Part 2: The Crux of this Submission

10. White Paper Policy Position 5.1 specifies:

"The objective of the [CPRS] is to meet Australia's emissions reduction targets in the most flexible and cost-effective way; to support an effective global response to climate change; and to provide for transitional assistance for the most affected households and firms" (emphasis provided).
11. Although the term "cost-effective" is used in relation to meeting Australia's emissions reduction targets, the White Paper states at page 3-1 that *"The target range is one element in a trajectory strategy... that aims to contribute constructively to a long-term global solution..."*. This seems to infer that the emission reduction targets, which the Government has committed to in both the White Paper and the exposure draft (i.e. between 5% and 15% below 2000 levels by 2020), are a measure to reduce global emissions. This apparent

inference in the White Paper seems to be supported by a statement by the Minister of Climate Change and Water, Senator Penny Wong, on 23 February 2009 that "*Delivering a target is a key part of domestic and international efforts to reduce carbon pollution*".

12. In fact, White Paper Policy Position 11.1 expressly qualifies Policy Position 5.1 by stipulating that "*Australia's emissions reduction targets are based on net national emissions; that is, imported units will be counted as contributing to meeting the national target...*".
13. In my opinion, cost-effectiveness must be assessed by weighing the benefits the CPRS will deliver in terms of meeting its targets (whether domestic or global) against the costs that are incurred in doing so. This is not inconsistent with the statement at page (xvi) of the White Paper, that the scheme is "*aimed at delivering substantial reductions in emissions while sustaining strong economic growth and securing our future prosperity*". However, in my opinion, the benefits must necessarily be measured as global benefits as domestic benefits cannot be derived unless there are benefits globally.
14. If this is a proper view, the exposure draft is ineffective in delivering White Paper Policy Position 5.1. The negligible environmental benefits that it could potentially provide to combat the global problem of climate change are outweighed by substantial potential losses in investment, employment, and Australia's international competitiveness. The irreparable economic damage the exposure draft will cause, particularly to Emissions-Intensive Trade-Exposed (EITE) industries is demonstrated by the case study on the LNG industry, in Part 5 of this submission.
15. Nothing in this submission is to deny the gravity of the risk of irreversible damage to the global economy and the global environment if climate change remains unchecked.

Part 3: What are the Environmental Benefits of the Exposure Draft?

16. The fossil fuel industry is pivotal to the global solution to climate change and much of the responsibility for reduction of emissions must devolve onto investors in that industry.
17. The International Energy Agency sees energy sector infrastructure needing around a trillion dollars invested every year until 2030. Governments do not have all this money, even if they try to print it, so it will mainly have to come from private sector investors. Governments everywhere must therefore review their policy settings to induce private sector investors to accept the heightened investment risks that now accompany the global economic downturn.
18. There will however be serious limits to what capital the private sector can provide. The global economic downturn may stymie the entire process of energy investment because of a shortage of both equity and debt capital. The Australian Energy Alliance, on whose Executive I serve, is about to embark upon an urgent study of the impact of the global economic downturn and the consequent drying up of energy sector investment that is already apparent.
19. Australian efforts to reduce domestic emissions and legislation to implement domestic action in Australia are pointless until other countries join in a globally-effective effort. The environmental benefits of the CPRS only exist in a hypothetical sense. As Professor Ross Garnaut said in a speech on 11 February 2009, "*there is negligible climate change benefit from Australia acting alone.*" In a January 2009 report, the Asia Society and the Pew Center on Climate Change of the US stated: "*The fact that a molecule of carbon dioxide emitted in the United States is just as harmful to the Chinese as one emitted in China is to Americans – or, indeed, to anyone on our planet – means that no human being is exempt from our inescapable commons.*"

20. Even if Australia successfully joined with other major emitters in a global emissions trading scheme, this may be too slow to be effective. According to the report of Working Group III in the IPCC Fourth Assessment Report, "...full implementation by all the [Kyoto] Protocol signatories, however, would still be far from reversing overall global GHG-emission trends." The Working Group considered that "Over the next 20 years or so, even the most aggressive climate policy can do little to avoid warming already 'loaded' into the climate system. The benefits of avoided climate change will only accrue beyond that time." The Working Group was of the view that "New research is required into the linkages between climate change and national local policies...that might lead to politically feasible, economically attractive and environmentally beneficial outcomes."
21. If Australia were to succeed in reducing domestic emissions by 5-15% by 2020 while the rest of the world did not do so, global emissions would be 50% higher than they are today and the exposure draft's global response objective would be of no benefit to Australia.
22. The biggest barrier to an effective climate change response is the difficulty of negotiating with sovereign governments over which Australia has no control and little influence. This is where the only real solution can be found and where the overwhelming focus of Australia's efforts should be concentrated.
23. China, India, Europe, the United States and other countries are responsible for 98.5% of global emissions and, unless they take effective action, any representation that a domestic measure such as the CPRS will save the Murray Darling Basin, the Kakadu Wetlands or the Great Barrier Reef unfortunately would be misleading.
24. The Prime Minister, when launching the White Paper on 15 December 2008 stated: "Without action on climate change, Australia faces a future of parched farms, bleached reefs and empty reservoirs. And we risk being left behind as other nations invest in the clean energy jobs and industries of the future". When the Minister for Climate Change and Water, Senator Penny Wong, released the exposure draft on 10 March 2009, she made a similar pronouncement, "As one of the hottest and driest countries on earth, Australia's environment and economy will be one of the hardest and fastest hit by climate change if we don't act now". These statements may be accepted by the general electorate as a reasonable description of the White Paper policy since the policy document itself is complex and fills two volumes. However, they fall far short of painting a realistic picture. As justification for the adoption of a domestic emissions trading scheme, these statements hold out false hope and do not logically justify the domestic action that the White Paper proposes and the Bill seeks to implement.
25. It is tempting to suppose that the CPRS may constitute a future environmental benefit by "[supporting] strong outcomes from the international negotiations ... [and taking] active steps to avoid a counterproductive standoff that risks inaction ..." (White Paper page 3-2). It is however to be doubted whether this possible future benefit could outweigh the economic costs that the CPRS will inevitably cause, particularly to trade-exposed industries.
26. It might be noted for the sake of completeness that Australia, pursuant to Article 3 of the Kyoto Protocol, has committed itself to the quantified emission limitation referred to in Annex B of the Protocol and may please itself as to how it satisfies its commitment.
27. As an aside, it should be noted that, with respect to the aforementioned commitment, Article 6 of the Protocol states that "The acquisition of emission reduction units [ERUs] shall be supplemental to domestic actions for the purposes of meeting commitments under Article 3". This supplementarity principle is acknowledged at page 84 of the Commentary to the exposure draft but at page 89 of the Commentary it is stated that "there will be no limit on the number of eligible international emissions units [which pursuant to Section 5 of the exposure draft include ERUs] that can be used for surrender to meet obligations under

the [CPRS]". This may be incompatible with the supplementarity principle, which requires internal abatement to take precedence over external participation in the Protocol's flexibility mechanisms.

Part 4: Economic Costs of the CPRS

28. As Professor Garnaut said in The Garnaut Climate Change Review, *"The continuation for long periods of strong Australian mitigation outside a global agreement is likely to corrode the integrity of the Australian market economy"*. In my opinion, the scheme as outlined by the exposure draft cannot be cost-effective as the "economic costs" that it imposes on EITE industries and, consequently, the Australian economy as a whole can not be justified by the negligible environmental benefit that the scheme purports to provide.
29. The scheme will particularly damage the international competitiveness of Australian trade-exposed export industries, which account for around 45% of Australia's emissions, imposing severe costs on the Australian labour and investment markets, and hence the economy.
30. Although the exposure draft provides that *"regulations may formulate a [EITE assistance program]"* under s167, which is designed to offset some of these costs, this program, if created, will only have limited effect in circumventing the problems that trade-exposed industries face. This is even more so in the case of those EITE industries that fall under the lower threshold of the EITE assistance program and accordingly only receive cover for 60% of their emissions, in particular the LNG industry.
31. The Business Council of Australia in a submission to the Centre for International Economics, in February 2009, stated that *"... for EITE industries the combination of having to purchase 40 per cent and 10 per cent of their 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...will adversely impact their business operations, in some cases reducing competitiveness and returns"*. The Business Council has emphasised that *"efforts must ensure the CPRS results in abatement that is lowest cost and that [EITE] industries are addressed in a manner that does not see them disadvantaged in the absence of a global carbon price"*.
32. The economic costs imposed by the CPRS are clearly illustrated by the case study on the LNG industry in Part 5 below.

Part 5: Case Study –the LNG Industry

33. In January 2009, ResourcesLaw was engaged by Woodside Energy Ltd to undertake a policy review ("the ResourcesLaw Review") of why and how Australia's liquefied natural gas (LNG) production and export industry should be shielded under the Carbon Pollution Reduction Scheme (CPRS) as promulgated in the Government's White Paper released by the Prime Minister on 15 December 2008. The purpose of this review was to review the efficacy of Australia's climate change policy as promulgated by the Government. It was not to question what the policy should be.
34. A copy of the ResourcesLaw Review accompanies this submission. Although the ResourcesLaw Review was commissioned by Woodside Energy, it represents ResourcesLaw's independent views.
35. Based on our policy review of the White Paper as we have depicted it in the **attached** table, ResourcesLaw concluded that the CPRS constitutes a serious failure of policy insofar as it affects the LNG industry. Our grounds for this conclusion are that:

- investment in Australian LNG will be constrained;
 - Australian LNG exports will be diminished;
 - there will be a consequential increase, not a decrease, in global greenhouse gas emissions;
 - this will result in irreparable economic damage being suffered by Australia for no environmental gain; and
 - the intended purpose of the policy as articulated in the White Paper cannot be fully achieved, because the global solution is impeded by the domestic mitigation strategy.
36. The irreparable economic damage that we refer to is the loss of export revenues and other flow-on economic benefits (including employment) that would have been derived from potential LNG projects that may be deferred in Australia. I consider it to be very unlikely that any existing project would close down but I do consider that deferral of project development is likely due to the impact of the CPRS on the competitiveness of Australian projects as I elaborate below. This likelihood is enhanced by the current global economic downturn.
37. As an indication of the order of magnitude of the flow-on economic benefits of a single LNG project, Woodside's Pluto Project in Western Australia involves an initial investment of \$12 billion. According to the project fact sheet published by Woodside, *"The project will create thousands of jobs and is expected to contribute more than \$28 billion to the Western Australian, and \$18 billion to the national economy, based on a two train development. It will also provide significant opportunities to local businesses, with the value of local content for the project estimated to be approximately \$6 billion."*
38. It is beyond any doubt that Australian LNG producers compete in highly competitive markets, not just against other LNG producers but against suppliers of competing fuels.
39. Contrary to popular belief, Australia is not a particularly successful competitor in the LNG production sector. Although Japan is Australia's largest and most important LNG customer, 82% of Japan's 2007 imports came from supplier countries other than Australia. These countries included Indonesia, Malaysia, Qatar, Brunei, Abu Dhabi and Oman. In the case of South Korea, 98% came from countries other than Australia and, in the case of Taiwan, 97%. This can be seen from Appendix A of the ResourcesLaw Review. China became an Australian LNG customer for the first time in 2007.
40. In my opinion, the imposition of carbon charges under the CPRS will place Australian LNG exports at a competitive disadvantage in all of its markets. This is in addition to the competition that LNG already faces from less-costly, higher-emissions fuels such as coal.
41. To the best of my knowledge, none of Australia's competing LNG suppliers have any present plan to impose any carbon charges on their LNG exports. In my opinion, the transitional assistance that may be available to the LNG industry as a trade-exposed industry under the CPRS will only partially redress Australia's competitive disadvantage.
42. Natural gas stands out as the paragon of fuels in the contemporary era. It enables many countries to make the transition to a lower-emissions economy and it complements the increasing use of renewable energy in their electricity generation systems.
43. LNG is a technology that enables natural gas in liquid form to be transported by ship to countries with insufficient natural gas resources of their own.

44. The role of natural gas in helping the world to progress to a sustainable energy future has been acknowledged by many organisations, including the Australian Clean Energy Council, the European Renewable Energy Council, Greenpeace International, the Intergovernmental Panel on Climate Change, the International Energy Agency, WWF International, and the World Energy Council. References to corroborate this may be found at footnotes 8 to 13 of the ResourcesLaw Review.
45. As elaborated in the ResourcesLaw Review:
- natural gas provides the fastest route to make the transition to a lower-emissions global economy;
 - LNG is the key fuel in progressing to a sustainable energy future. It is a major source of safe, cleaner energy, offering the lowest emissions of any fossil fuel and is the perfect complement to renewable energy;
 - LNG actually reduces global carbon pollution by displacing higher emissions fuels;
 - over the next 10 – 15 years, Australian LNG exports could reduce global emissions by up to 140 million tonnes per annum, equivalent to 20% of Australia's 2006 emissions;
 - LNG has a pivotal long-term role as the balancing and back-up fuel in electricity systems that rely on renewable energy;
 - LNG projects are highly capital intensive and sensitive to increases in costs (as noted in the ResourcesLaw Review, a recent report by Concept Economics has highlighted that changes in costs, such as those imposed by an ETS, are enough to make many LNG projects unviable. Even with a 60% level of permit allocation, output of the Australian LNG industry would still be between 16 and 37% below the reference case level in 2020 and between 39 and 54% down on what it would otherwise be by 2030); and
 - LNG alleviates the energy security concerns of importing countries.

Part 6: Conclusions

46. I recommend that all EITE industries be shielded from the impact of the CPRS on cost-benefit grounds.
47. I recommend that the LNG industry be shielded from the impact of the CPRS on both cost-benefit and environmental grounds.
48. I further recommend that accelerated development of Australia's LNG projects should be adopted as an urgent economic priority by Australia.
49. The Government has a choice of four measures if it wishes to shield any industry: (i) scheme exemption, (ii) crediting overseas emission reductions, (iii) full allocation of emission permits or (iv) tax relief.
50. I recommend that the Government should focus all of its efforts on the international climate negotiations.
51. I particularly recommend that the Government give consideration to the initiation of an international sectoral agreement for the LNG industry to speed up global emission reductions and provide energy security benefits for energy-importing countries. This could

be of benefit to Australia in the international climate negotiations and is elaborated in Appendix B of the ResourcesLaw Review.

52. Finally, I add for the sake of balance that energy source diversity is the bedrock of robust energy systems and I acknowledge a potential role for all energy technologies in reducing global emissions.

I am willing to appear before the Committee to answer any questions that may arise from this submission.

Yours faithfully

Robert Pritchard
Managing Director
ResourcesLaw International

Table: The Structure of Australia's Climate Change Policy

POLICY GOAL	
CONTRIBUTE TO THE GLOBAL SOLUTION TO A GLOBAL PROBLEM	
Policy Pillar	Policy Measures
First pillar: reduce Australia's emissions ("the domestic mitigation strategy")	<p>(1) The CPRS ("the primary mitigation measure") to commence on 1 July 2010 with emissions caps to be progressively lowered and various assistance measures to be administered, including the Climate Change Action Fund</p> <p>(2) A Renewable Energy Target (RET) of 20% by 2020</p> <p>(3) Carbon Capture and Storage (CCS)</p> <p>(4) Energy Efficiency</p>
Second pillar: adapt to climate change that we cannot avoid	<p>(1) National Adaptation Framework</p> <p>(2) Water for the Future Fund</p>
Third pillar: help shape a global solution	<p>(1) Negotiation of the post-Kyoto international framework</p> <p>(2) Other international initiatives, such as:</p> <ul style="list-style-type: none"> - Global CCS Institute - International Forest Carbon Initiative - Asia-Pacific Partnership on Clean Development and Climate