

# Chapter 3

## Response to business concerns

3.1 The bills introduced into Parliament on 14 May 2009 include a number of changes which were made in response to industry representations. This chapter looks at some of these major changes, including the additional allocation of permits to trade exposed industries via the 'global recession buffer', changes to treatment of landfill, and changes made to reviews of assistance.

3.2 Further discussion of the impact of the Global Financial Crisis, and the delays in the commencement of the scheme arising from it, is provided in Chapter 5.

### **EITE assistance and the global recession buffer**

3.3 In his second reading speech on introduction of the CPRS Bill, the Parliamentary Secretary for Climate Change, the Hon Greg Combet MP, provided the following explanation for providing assistance for companies in the Emissions-Intensive Trade-Exposed (EITE) category, and for providing additional assistance in the form of the global recession buffer:

Free emissions permits will be issued to our emissions-intensive trade-exposed industries to reduce the risk of 'carbon leakage'. Carbon leakage occurs when industries move from Australia to elsewhere, with no benefit in terms of global emissions reductions, upon introduction of a carbon price in Australia. This risk occurs when Australia imposes a carbon price on our trade-exposed industries ahead of competitor economies. Transitional industry assistance is designed to reduce this risk. Regulations will provide the detail of eligible industries and rates of assistance, but the key parameters have been elaborated in significant detail in the white paper and the Prime Minister's announcement of 4 May 2009.

As announced on 4 May 2009, a global recession buffer will be provided for emissions-intensive trade-exposed industries for the first five years of the scheme, in addition to previously announced rates of assistance.

This buffer will provide an additional five per cent free permits for EITE activities eligible for 90 per cent assistance, giving an effective rate of assistance of almost 95 per cent to these highly emissions-intensive trade-exposed activities in the first year of the scheme.

The buffer will provide an additional 10 per cent free permits for EITE activities eligible for 60 per cent assistance, giving an effective rate of assistance of 66 per cent to these moderately emissions-intensive trade-exposed activities in the first year of the scheme.

Rates of assistance will decline at a rate of 1.3 per cent per year, in line with the carbon productivity contribution set out in the government's white paper.<sup>1</sup>

3.4 Some economists regarded the timing of this assistance as inconsistent with the Government's own macroeconomic forecasts:

The five per cent recession buffer is interesting given that the government is forecasting 4.5 per cent growth in its budget over the same timeframe.<sup>2</sup>

3.5 Provisions concerning EITE assistance can be found in Part 8 of the CPRS Bill. The detail of the EITE programme will be contained in regulations. The Department of Climate Change is currently engaged in a process with industry of identifying industry activities which will be eligible for assistance under the EITE programme.<sup>3</sup>

3.6 The Department of Climate Change has indicated that the 'primary reason' for the increased allocation of free permits was the global recession.<sup>4</sup> The Global Recession Buffer is expected to cost an additional \$1 billion over five years, with assistance rising from \$70 million in 2011-12 (the time at which the cost of permits will be capped to \$10) to \$290 million in 2015-16.<sup>5</sup> This comes in addition to previously announced assistance provided to industry under the EITE programme.

### ***Carbon Leakage – economic arguments***

3.7 The committee heard a diverse range of views concerning the true extent of likely 'carbon leakage' after implementation of the scheme, and the necessity for increasing the level of assistance already announced in the *White Paper*.

3.8 The Productivity Commission has acknowledged that there is an 'in-principle' argument in favour of providing assistance to emissions intensive trade exposed industries, but that judging the correct level of assistance presents difficulties:

In practice, determining the level of assistance to EITE activities is complicated by uncertainty about the extent of carbon leakage. A global

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1 Hon Greg Combet MP, Parliamentary Secretary for Climate Change, *Proof House of Representatives Hansard*, 14 May 2009, pp 10-11.

2 Mr Salim Mazouz, Director, EcoPerspectives, *Proof Select Committee on Climate Policy Hansard*, 20 May 2009, p. 45.

3 Senator the Hon Penny Wong, Media Release PW 86/09, 'Defining emissions intensive industries under the Carbon Pollution Reduction Scheme, 1 April 2009, <http://www.environment.gov.au/minister/wong/2009/mr20090401.html>, viewed 1 June 2009.

4 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p. 7.

5 Styles, Jule & Talberg, Anita, Parliamentary Library Briefing Note, 'Budget 2009-10: Climate Change and Energy', [http://www.aph.gov.au/library/pubs/RP/BudgetReview2009-10/Climate\\_Energy.htm](http://www.aph.gov.au/library/pubs/RP/BudgetReview2009-10/Climate_Energy.htm), viewed 1 June 2009.

carbon constraint would help abatement activities shift to where they impose the lowest costs. However, if Australia imposes a constraint ahead of other countries, production may shift to countries not because of cheaper abatement opportunities, but because firms in those countries do not pay the full price of their pollution. So, judging the extent of carbon leakage requires estimating a counter-factual: what activities would stay in Australia in the environment of a uniform and consistent global carbon constraint?

Accordingly, identifying activities that may contract, shut-down or shift offshore following the introduction of a domestic constraint is not sufficient. The test for carbon leakage is whether these shifts would still have occurred even if other countries efficiently constrained their carbon usage. The difficulty in forming these judgements make it likely that any policy response will at times fail to protect against carbon leakage and also at times provide assistance where no carbon leakage would have otherwise occurred.<sup>6</sup>

3.9 Many organisations characterised 'carbon leakage' as a significant threat. Dr Brian Fisher provided the following example:

There is no doubt that, if you are faced with a regime that taxes methane—which, as a greenhouse gas, is 21 times more potent than carbon dioxide—at the rate that is potentially suggested, there is no doubt that any gaseous mine will become less competitive; and it will become potentially radically less competitive than mines, for example, in Indonesia. As a consequence of that, jobs will be lost from those mines in Australia.<sup>7</sup>

3.10 Similar concerns were expressed by Dr Moran of the Institute of Public Affairs:

If the major users of energy have to incur a cost or a doubling of the price of the energy—even if energy is 20 per cent, and it is rather more than that in the case of aluminium—then they would not be competitive and they would move offshore. Even quite small changes in price do cause firms to move offshore, as we are seeing in terms of all the globalisation debates of industries like Adidas, Puma and organisations like that moving where they manufacture their shoes from one country, Indonesia, to Vietnam et cetera on the basis of quite small changes in costs. That is the sort of reality of the world economy as it is now.<sup>8</sup>

3.11 Many other economists take the view that the concerns about carbon leakage are exaggerated and/or that the assistance in the CPRS is more than enough to prevent it. The author of the *Stern Review* recently wrote:

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6 Productivity Commission, *Trade Assistance Review 2007-08*, 27 May 2009, p. 109. This is a similar view to that put in R Garnaut, *The Garnaut Climate Change Review*, 2008, (hereafter *Garnaut Review*).

7 Dr Brian Fisher, *Proof Committee Hansard*, 29 May 2009, p 44.

8 Dr Alan Moran, *Proof Committee Hansard*, 22 May 2009, p. 30.

...the evidence from studies of the mobility of firms in response to environmental policies is that it is negligible.<sup>9</sup>

3.12 Mr Richard Denniss of the Australia Institute has argued:

I think the risk of carbon leakage is overstated. We have to ask ourselves: where was all the exchange rate leakage when the exchange rate was US\$0.90? The fact is that a lot of mobile capital stayed put—and for good reason. And carbon leakage is not the only risk that Australia faces, from an economic point of view. It is certainly not the only risk that big investors face.<sup>10</sup>

3.13 This view was also strongly expressed to the committee by environmental groups:

...the emissions trading assistance is in excess of what is genuinely needed in terms of the threats...<sup>11</sup>

...the claims made are overexaggerated, that the risk of so-called carbon leakage is overstated...<sup>12</sup>

I think that the claims that are being made by industry are very exaggerated. I find it extraordinary that so many major corporations, who have been on notice for a very long time and have been preparing for this for a very long time, can claim that they will not be able to innovate to deal with this.<sup>13</sup>

3.14 The potential for permit allocation under the EITE assistance programme to exceed actual emissions for some companies was tacitly acknowledged by the Department of Climate Change:

The other point to make is that the basis of that assistance is provided on 2007-2008 intensity baselines. To the extent that industries have been able to improve their emissions intensity efficiency over the period to the commencement of the scheme, that does not reduce the amount of assistance provided but does reduce their liability under the scheme. So the level of actual liability for the most emissions intensive firms is significantly reduced by the emissions-intensive trade-exposed assistance and moves it to a level that is relatively small compared with the overall costs.<sup>14</sup>

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9 Sir Nicholas Stern, *A Blueprint for a Safer Planet*, 2009, p 164.

10 Dr Richard Denniss, Executive Director, The Australia Institute, *Proof Select Committee on Climate Policy Hansard*, 20 May 2009, p. 51.

11 Mr John Connor, Climate Institute, *Proof Committee Hansard*, 29 May 2009, p 59.

12 Mr Owen Pascoe, Australian Conservation Foundation, *Proof Committee Hansard*, 29 May 2009, p 72.

13 Mr Paul Toni, World Wildlife Fund, *Proof Committee Hansard*, 29 May 2009, p. 64.

14 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p. 5.

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### *Committee View*

3.15 In its inquiry into the exposure drafts of the carbon pollution reduction scheme legislation, the Standing Committee on Economics found that carbon leakage was a matter of genuine concern:

The Committee regards carbon leakage and the need to smooth the adjustment process to a low-carbon economy as good reason for some government assistance to industry...The CPRS structures these assistance measures in a manner that retains incentives to take measures to reduce emissions of greenhouse gases.

The committee notes the persistent advocacy of industry groups for further assistance under the scheme. On the other hand other stakeholders have criticised the scheme for being too generous to polluting industries.

The committee believes that the Bill has the balance right, retaining strong incentives to reduce carbon intensity while enabling important economic assets to remain viable throughout the adjustment. This is fundamentally important to protecting jobs and enabling jobs in the green economy to grow.<sup>15</sup>

3.16 The committee remains satisfied that carbon leakage is a legitimate concern, and that there are strong arguments in favour of providing transitional assistance to trade-exposed industries. The committee sees no virtue in the elimination of an emissions intensive industry in Australia (and consequent loss of jobs) if that industry simply relocates to another jurisdiction where it is allowed to pollute more heavily. Such a scenario would lead to no net gain in terms of global emissions reductions. Ideally, however, assistance to these industries should continue only until industries on competitor countries face a similar emissions constraint.

### ***Free permits versus auctioning***

3.17 The Government intends that, after a period of transition, all permits will be auctioned. This is consistent with the fundamental idea that the CPRS is correcting the problem that CO<sub>2</sub> emissions (like all other forms of pollution) will be too high if those responsible for them do not bear the resulting cost:

...auctioning permits ensures that the entities who are responsible for high levels of emissions are the ones that pay for the environmental costs (consistent with the 'polluter pays' principle).<sup>16</sup>

The Carbon Pollution Reduction Scheme will build a low-pollution economy of the future for Australia. Under the Scheme, Australia's biggest polluters will pay for the pollution they generate...<sup>17</sup>

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15 *CPRS ED Report*, p. 70.

16 *Carbon Pollution Reduction Scheme: Australia's Low Pollution Future*, December 2008 (hereafter *White Paper*), p 9-4.

3.18 However, auctioning was criticised by some industry representatives. The Minerals Council of Australia (MCA) cited some economic literature that holds that there is little difference in terms of environmental impact as to whether permits are auctioned or allocated by other means.<sup>18</sup> Dr Brian Fisher (in his capacity as Chief Executive Officer, Concept Economics, which provided consultancy services for the MCA) argued that auctioning of permits from commencement were not necessary to drive environmental benefits:

This issue is being debated long and hard. The reason that most economists put that point of view is simply that, whether or not the permit is given to you, you still face the same opportunity cost; basically, your costs as an operator are still the same. Whether you are transferred a permit is a matter of an income transfer; it is not an efficiency question. As a consequence of that, the vast majority of the literature on this matter says that it makes no difference.<sup>19</sup>

3.19 Because it argues there is little *environmental* impact from free allocation of permits, the MCA asserted that there is no justification for the additional *economic* impacts it argues arise from imposing auctioning of permits on their industry. Mr Hooke expressed the opinion that auctioning permits from commencement of the scheme was the 'essential and fundamental flaw' in the CPRS.<sup>20</sup>

3.20 There are three main problems with the MCA argument. Firstly, *even if* giving the mining sector free permits still retains an incentive to reduce emissions, this is not an argument for making such a large income transfer to the mining sector anymore than it is an argument for making a large income transfer to any other sector.<sup>21</sup> Such a transfer to the mining sector has to be justified on some public policy grounds such as the above argument on carbon leakage, which then implies it is appropriate that the transfer be limited in time and coverage.<sup>22</sup>

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17 Australian Government, *The Carbon Pollution Reduction Scheme and You*, 2008.

18 The MCA gave the example of Eileen Claussen of the Pew Centre on Global Climate Change in this context.

19 Dr Brian Fisher, Chief Executive Officer, Concept Economics, *Proof Committee Hansard*, 29 May 2009, p. 45.

20 Mr Mitch Hooke, Chief Executive Officer, Minerals Council of Australia, *Proof Committee Hansard*, 29 May 2009, p. 34.

21 As Sir Nicholas Stern puts it, 'auctioning is superior to free allocations...it raises revenue for the government. Giving away that revenue as transfers to firms through free allowances would be a peculiar and inegalitarian use of public money'; *A Blueprint for a Safer Planet*, 2009, p 108.

22 As Stern comments, 'The argument for temporarily free allocations, or for phasing in the auctioning of permits – that they help with the adjustment process...has more substance'; *A Blueprint for a Safer Planet*, 2009, p 108.

3.21 Secondly, it is not uncontested that the environmental impact from giving permits to large polluters will always be the same as under auctioning. As argued in the *White Paper*:

In practice, because administrative allocations will be made for reasons other than pure efficiency, the initial allocation of permits will not be made to the highest valuing users. Firms will be able to trade permits in the secondary market, but trading costs and information issues mean that this will not be costless. Furthermore, international experience suggests that where permits are issued for free there may initially be some inefficient hoarding by the recipients.<sup>23</sup>

3.22 This view is supported by the author of the *Stern Review*:

...auctioning can hasten adjustment. The longer allocations are given free, the less pressure there is on firms to move quickly. It is true that the marginal incentive of a carbon price should give a strong reason to economise on emissions even if allocations are given free. But that pressure is intensified if weak or no adjustment implies significant losses, rather than profits simply being lower than they might otherwise be.<sup>24</sup>

3.23 Finally, the Department of Climate Change argued that the MCA proposal is not predicated on the assumptions made by those economists arguing that the environmental outcome is invariant to the means of allocating permits:

It is true that, if you provide permits to people, and you do it in such a way that they are fully tradeable after you give them to them and they are not conditional on the amount of output that they continue to produce, in some circumstances you can have incentives to reduce emissions. But, as far as I am aware, that is not the proposal that the Minerals Council have been putting forward. They tie the amount of permits to the amount of production, and in that case you significantly reduce the incentives to undertake emissions reductions to achieve an environmental outcome. So, in terms of the actual proposal that the MCA has been talking about, there is a significant blunting of the environmental incentives compared with the Carbon Pollution Reduction Scheme.<sup>25</sup>

3.24 The question therefore before the committee is whether the amount of temporary EITEs assistance provided in the bills is appropriate, and whether circumstances exist to justify the increased level of support announced on 4 May 2009.

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23 *White Paper*, p. 9-3.

24 Sir Nicholas Stern, *A Blueprint for a Safer Planet*, 2009, p 108.

25 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Legislation Committee on Finance and Public Administration Hansard (Estimates)*, 29 May 2009, p. 24.

*Is the revised level of assistance adequate?*

3.25 The committee was presented with a diverse range of views about the potential impact of the expansion of temporary EITE assistance through the global recession buffer.

3.26 The increased assistance was welcomed by organisations representing the industry sector, including the Australian Industry Group (Ai Group) and the Business Council of Australia.<sup>26</sup> However, these groups have flagged their intention to continue working with government on the content of the package, and both have nominated EITEs assistance as an area where improvements are possible. Both organisations have stopped short of saying the level of assistance is now sufficient:

**Senator EGGLESTON**—To go specifically to some of the changes, you talked about emission-intensive, trade-exposed industries, but under these changes there is only going to be a five per cent increase in coverage for a period of five years from 90 to 95 per cent, from 60 to 65 per cent and then five-yearly reviews. Five per cent in many quarters is not regarded as a very sufficient additional coverage. What is your opinion?

**Mr Burn**—I just wonder if coverage is the appropriate term. What the five percent will do will be for those activities raise the overall allocation to 94 and a half per cent—

**Senator EGGLESTON**—That is what we are talking about, yes.

**Mr Burn**—The 10 per cent increase for the lower threshold will raise it to 66 per cent. Is that adequate? That is a different issue, but it is better than what was on offer before. That is why we welcomed the changes, of course.<sup>27</sup>

3.27 Other industry representatives recorded views more forcefully that the level of temporary assistance provided under the bills for trade exposed industries, even including the global recession buffer, remains inadequate:

Rio Tinto retains the position that all EITE activities should maintain their initial percentage allocation of permits (ie, 60 per cent and 90 per cent as well as the additional recession buffer) until 80 per cent of all carbon emissions globally are covered by a comparable carbon constraint.<sup>28</sup>

The Amended Draft Legislation does not remedy the fundamental flaws that have been addressed in all previous submissions. The negative impact on the international competitiveness of trade exposed Australian industry, such as the LNG industry, in an international market has the potential to cost Australian jobs and tax revenues, not have the intended effect on

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26 Mr Peter Burn, Director Policy, Australian Industry Group, *Proof Committee Hansard*, 29 May 2009, p. 13.; Ms Maria Tarrant, Director, Policy, Business Council of Australia, *Proof Committee Hansard*, 22 May 2009, p. 13.

27 *Proof Committee Hansard*, 29 May 2009, p. 16.

28 Rio Tinto, *Submission 23*, p. 7.



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reducing global emissions and in fact probably increase global GHG emissions.<sup>29</sup>

The change to the assistance for emissions-intensive, trade exposed (EITE) industries announced on 4 May 2009 will do little to relieve the burden that will be imposed on Caltex's two oil refineries. We currently expect a nominal assistance rate of 60% although this is still subject to negotiation with the Department of Climate Change and the Government. The proposed Global Recession Buffer will reduce the CPRS productivity tax from a nominal rate of 40% to 34% for five years, which does little to cut the burden in the first five years and nothing in the longer term.<sup>30</sup>

3.28 Some analysts from the finance and investor sectors recorded their view that the current level of assistance is now satisfactory, and that the CPRS is now no longer a matter for concern from the point of view of investors:

Based on research by IGCC members Goldman Sachs JBWere and Citi Investment Research on the top 100 listed companies in Australia, IGCC believes that compensation to EITE companies will result in minimal financial impact on these companies in the short to medium term. IGCC believes the extension of compensation levels means that existing investors in these companies will receive sufficient protection to avoid capital flight in the early years of the scheme.<sup>31</sup>

Most fund managers I speak to are pretty sanguine, feeling that the impact of the CPRS will be small given the number of free permits that will be allocated. They feel that other influences like commodity prices, exchange rates and the state of the global economy are more important to their investment decisions.<sup>32</sup>

3.29 The Committee's attention was also drawn to studies that show that industry typically overstates the cost and difficulty of adjusting to environmental measures:

I have a report by the Economic Policy Institute in Washington, which did an analysis of the before and after costs of pollution regulations in America, including some that are directly parallel in terms of capturing emissions from industrial plant. Without exception they found that the costs were exaggerated...<sup>33</sup>

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29 ConocoPhillips, *Submission 26*, p. 4.

30 Caltex Australia, *Submission 27*, p. 2.

31 Investor Group on Climate Change, *Submission 41*, p 3.

32 Ms Elaine Prior, Director and Senior Analyst, Citi Investment Research, *Proof Select Committee on Climate Policy Hansard*, 20 May 2009, p. 84.

33 Mr Paul Toni, World Wildlife Fund, *Proof Committee Hansard*, 29 May 2009, p 66. The literature survey, 'Falling prices: cost of complying with environmental regulations almost always less than advertised' shows that in eleven of twelve the initial estimates of compliance costs were more than double the actual costs.

3.30 A number of organisations expressed their opposition to the increased level of assistance provided by the global recession buffer. For many of these organisations, this is consistent with their opposition to the previous level of EITE assistance on offer before the Government's announcement on 4 May 2009. As noted above, many groups regard the arguments about carbon leakage as exaggerated.

3.31 Uniting Justice Australia noted its concern about the additional level of assistance provided via the buffer:

The Uniting Church has been supportive of assistance to Australia's most emissions-intensive, trade-exposed industries, on the grounds of avoiding 'carbon leakage'...We are, however, concerned about the increased assistance to EITE industries through the 'Global Recession Buffer' and the potential for increasing costs in other parts of the economy and potentially reducing the incentives and economic signals driving investment towards low-carbon industries and activities.<sup>34</sup>

3.32 Several environmental groups saw the revenue to be allocated to industry assistance as being better used to promote alternative sources of energy.<sup>35</sup> For example, the Australian Conservation Foundation advised:

...senators may be aware of a report we commissioned from Risk Metrics recently that showed that, following the changes as of 4 May, free permits worth \$16.4 billion would be handed out to our most polluting industries and coal power generators over the first five years of the scheme. That would include \$565 million worth of free permits for Rio Tinto in just the first full year of the scheme.

That is a very large figure. If the \$16.4 billion permits were actually auctioned rather than given away that would be enough to fund at least 30 large scale solar plants, based on the government's budget announcement. That is enough to put a solar plant next to every coal-fired power station in Australia. To this end, we have been calling for the assistance to the big polluters to be limited and for 20 per cent of the CPRS revenue to be put into renewable energy and low emissions technologies to help boost our moves towards a low carbon economy.<sup>36</sup>

3.33 The Climate Action Network Australia advised the committee that five of its 67 member associations support passing the legislation if further amendments were considered, whilst 14 rejected the changes.<sup>37</sup>

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34 Uniting Justice Australia, *Submission 5*, p. 3.

35 Mr John Hepburn, Coordinator, Climate and Energy Campaign, Greenpeace Australia Pacific, *Proof Select Committee on Climate Policy Hansard*, 20 May 2009, p. 21.

36 Mr Owen Pascoe, Australian Conservation Foundation, *Proof Committee Hansard*, 29 May 2009, p. 68.

37 Climate Action Network Australia, *Submission 2*, p.1.

3.34 Professor Ross Garnaut noted that the package could lead to some companies receiving more assistance than necessary to avoid carbon leakage:

I am on the public record in my report and also in the evidence I gave to this committee and the other Senate committee earlier in saying that I do not think that Australia has adopted the ideal approach to assistance for trade-exposed industries. I now accept that we are not going to get a big reform of that except in the context of changes in the international environment—a comprehensive agreement that leads to comparable emissions constraints in the main countries or agreement perhaps within the WTO on comparable ways of achieving these things. Under the proposal of the government, comparing that with the assistance that industries would get under a principled approach that really dealt with the carbon leakage issue in an efficient way, my assessment, my estimate, would be that a number of industries are getting much more than would be necessary to avoid carbon leakage and some would be getting less. I have accepted that that is where our discussions are at the moment and we need progress in the international sphere to unwind the imperfections in the system.<sup>38</sup>

### *Review of assistance mechanisms*

3.35 There have been calls to ensure that industry assistance does not continue longer than necessary; other stakeholders argued that industry assistance should not cease too soon if the rest of the world has still not taken appropriate action.

3.36 Professor Ross Garnaut advised that EITE assistance should continue no longer than necessary:

I think the most important thing is that we make it clear we are going to get rid of the system of assistance for trade exposed industries when the rationale for it disappears. The rationale will have disappeared either when we have comparable emissions constraints in a large part of the rest of the world or when the major countries of the world have agreed on a comparable and principled approach to assisting trade exposed industries.<sup>39</sup>

3.37 This points to the need for robust review mechanisms to be in place. This is recognised by the Government in its characterisation of EITE assistance as 'transitional' and the establishment of independent review processes to consider any modifications to the EITE assistance programme.<sup>40</sup>

3.38 A number of changes have been made in the bills to the processes for reviews of assistance. In particular, more detail has been provided on provisions relating to matters to be considered in the five-yearly independent reviews of assistance and in

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38 Professor Ross Garnaut, *Proof Committee Hansard*, 22 May 2009, p. 15.

39 Professor Ross Garnaut, *Proof Committee Hansard*, 22 May 2009, p. 18.

40 CPRS Bill 2009 *Explanatory Memorandum*, pp 252-4.

the composition of expert advisory committees. These changes are reflected in clause 353 and subclause 360(5).

3.39 The need to wait five years for a formal review received some comment in evidence provided to the committee. In particular, the five year duration of the global recession buffer, and its extent, were criticised by some witnesses:

We certainly do not support the five-year notice period provided to EITEs. We believe that is certainly way too long. A five-year notice period really does make it difficult for us to move with new developments in climate change science, in international developments and in new technologies that are coming forward. As I believe the previous speaker was outlining, we have seen in other pieces of environmental legislation that the costs after the fact are actually found to be a lot less than predicted. We certainly would not want to lock in assistance which turned out to be overgenerous, more than was necessary to compensate these industries.<sup>41</sup>

3.40 The Department of Climate Change, noted some of the factors that can be considered in the reviews of industry assistance:

There are three levels of the nature of the change in assistance. The first is the 1.3 per cent per year reduction in the rate of assistance which happens each year, and that is an automatic reduction in the rate of assistance. The second is the removal of the global recession buffer after a five-year period. The third is that, if there is a review conducted of the international environment, the review would essentially look at the extent of carbon constraints that have been imposed in the rest of the world.

An important part of that review is that it will need to look at both industries and sectors to look at carbon constraints in different areas, but it would also have to look at the total level of emissions reductions commitments across the globe. The broad intention is to look at the extent of carbon constraints in different countries, bearing in mind that they will not all be in the form of emissions trading schemes and they will not all be in the form of carbon taxes. So the review will have to do an analysis of the effective level of carbon price imposed in each country.<sup>42</sup>

3.41 Mr Daniel Price of Frontier Economics noted that, whatever formal timelines exist for review, it was likely that governments would monitor the scheme throughout and make adjustments as required. He cited the experience of reform of electricity markets:

This is in the realm of highly organised energy markets, in that there are very strict rules of engagement and price-setting rules. I was always in favour, going back 15 years, of having a review soon after that market

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41 Mr Owen Pascoe, Australian Conservation Foundation, *Proof Committee Hansard*, 29 May 2009, p. 73.

42 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Committee Hansard*, 22 May 2009, p. 10.

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started in case we got something fundamentally wrong. In fact, the Western Australian Labor government put in place an electricity market there which was very different from any other market in Australia and they required an annual review. In the first review, the regulator there took the view that there were signs the market may not be working quite as they intended but that the market should be allowed to continue on, and so they kept a watching brief over that. But let us say that there was a timed review in 2014. Governments do not just walk away and let a market fall apart. Almost certainly, any responsible government, if they saw something going fundamentally wrong, would probably step in and make a change. So I think it is probably a moot point as to whether it is a timed review or one that is ongoing, because governments generally are pretty responsible about these things.<sup>43</sup>

### ***Comparison with US Waxman-Markey Bill***

3.42 One of the arguments against the currently proposed level of industry assistance provided to the committee was the assertion that other countries were providing a higher level of support to their own trade exposed industries. A frequently used example was the American Clean Energy and Security Act 2009 (commonly known as the Waxman-Markey Bill), which was passed by the United States House of Representatives Committee on Energy and Commerce on 21 May 2009.

3.43 An example of some of the views expressed in relation to the US Bill was the following call for greater alignment with US proposals made by Bluescope Steel/OneSteel:

Given the global significance of the US, we believe that it is important to obtain a clear understanding of the design of United States' emissions trading scheme, including its provisions for assistance to EITEs, and to fully consider the implications of the US approach for the design of Australia's CPRS. The current draft US legislation appears to differ markedly from the Australian scheme in a number of important respects, including the later commencement date, broader activity coverage for affected sectors including steel, and a more prescriptive and quantitative test for international action.

The precedent set by the US is particularly important for the iron and steel industry. Approximately 30% of BlueScope Steel's exports from its Australian operations go to the United States. The Australian steel industry also competes with US steel producers in third party export markets. It is essential that material differences between Australian and US climate change legislation do not distort our trade competitiveness.

At a minimum, the Government should ensure that the important precedent set by the US is acknowledged, and that it has sufficient flexibility to adjust the CPRS as US policy becomes clearer. This will assist in ensuring that

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43 *Proof Committee Hansard*, 22 May 2009, pp 40-41.

Australian industry is not put at a disadvantage with respect to its international trade competitors.<sup>44</sup>

3.44 The Department of Climate Change has responded to unfavourable comparisons between the proposed levels of industry assistance in the CPRS Bills and in the US proposal in the following terms:

Most importantly however, and contrary to some of the reporting, neither scheme guarantees 100 per cent assistance to industries at risk of carbon leakage.

In fact, the Waxman-Markey Bill has set a hard cap on allocations to these industries at 15 per cent of total permits in 2014, falling to 13.4 per cent in 2016. This initial allocation is substantially lower than the CPRS policy, where around 27 per cent of permits will be allocated to EITEs in the first year of scheme. Direct comparisons of these shares should be treated with caution given the different economic structures of the two countries, but information provided to the Committee via testimony from a US energy intensive industry representative suggests that even at commencement, assistance to EITE industries could be less than 100 per cent.

The number of permits that will be allocated to these industries over subsequent years will be directly linked to the decline in the US cap on emissions, with no provision for increased allocations in response to growth in these industries – in this sense there are similarities with our Green Paper model but with a lower share of permits available for EITEs.

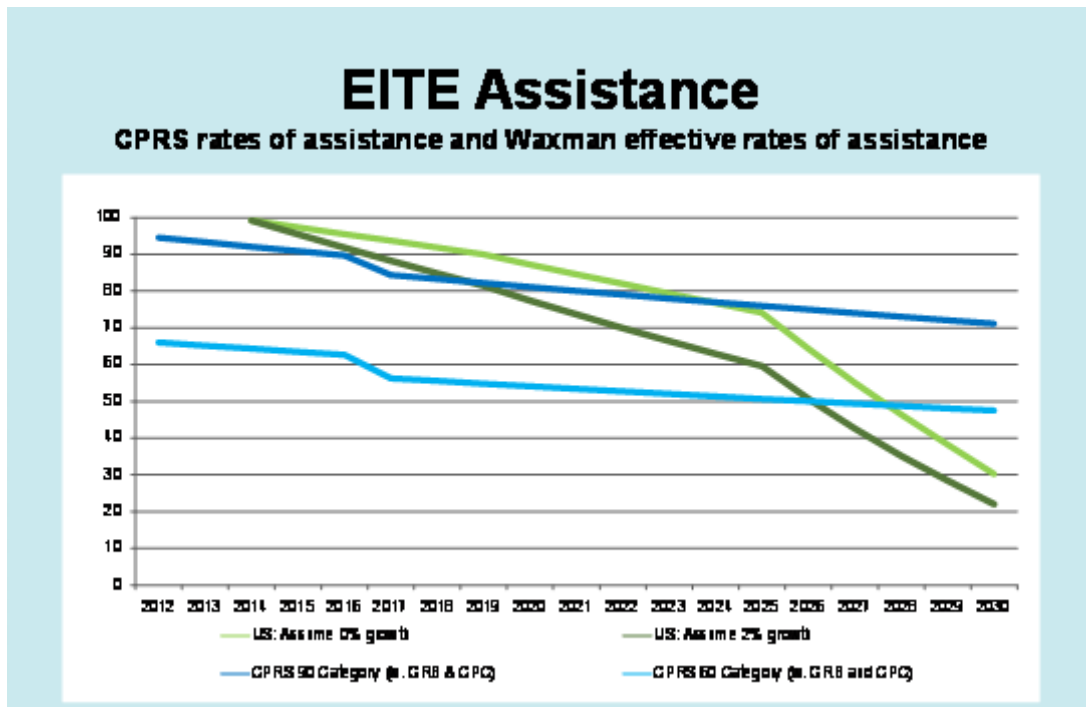
This means that if the calculated allocations to US EITEs are greater than the number of permits that have been set aside for them, allocations to each EITE will be reduced accordingly. In addition, if emissions from US EITEs increase (on account of these sectors growing) and the overall cap on emissions falls, the effective rates of assistance to EITE industries will decline. This is because the number of permits available for allocation to EITEs will be falling while the total number of emissions from these industries is increasing.<sup>45</sup>

3.45 The Department of Climate Change has provided the attached chart to summarise the different levels of assistance to trade exposed industries under the CPRS Bills and the latest version of the Waxman-Markey Bill. As discussed by Mr Comley in the preceding paragraph, the proposed rate of assistance for trade exposed industries under the Waxman-Markey Bill will decline as a proportion of emissions liability over time:

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44 Bluescope Steel/OneSteel, *Submission 10*, p. 2.

45 Mr Blair Comley, Deputy Secretary, Department of Climate Change, Speech to APPEA conference and exhibition, [http://www.climatechange.gov.au/media/2009/pubs/Comley\\_APPEA.pdf](http://www.climatechange.gov.au/media/2009/pubs/Comley_APPEA.pdf), viewed 3 June 2009, pp 9-10.



Source: Mr Blair Comley, Deputy Secretary, Department of Climate Change, Speech to APPEA conference and exhibition, [http://www.climatechange.gov.au/media/2009/pubs/Comley\\_APPEA.pdf](http://www.climatechange.gov.au/media/2009/pubs/Comley_APPEA.pdf), viewed 3 June 2009

3.46 There may be many iterations of the Waxman-Markey bill, including the level of assistance provided to export industries, before it is ultimately passed by the US Congress. However, it is likely that any bill passed by Congress will include some level of assistance for trade exposed industries.

### *Detail in regulations*

3.47 A number of stakeholders expressed concern that important details of the EITE assistance programme will be contained in the regulations:

We also remain concerned that EITE activities will be defined in regulations rather than legislation, despite the fact that these definitions will be crucial in determining whether the Government delivers on its commitment to ensure no competitive disadvantage for EITEs. Similarly, the eligibility criteria for EITE assistance and the timing and rate of decay in EITE assistance – both critical issues for the iron and steel industry – are also not dealt with in the Bill but will be dealt with in regulations.<sup>46</sup>

3.48 Others express concern that the proposed regulations are not currently available:

I think there is for us a concern around the sequencing of the act versus the regs. A lot of the detail to do with the emissions-intensive trade-exposed is

46 Bluescope Steel/OneSteel, *Submission 10*, p. 2.

in the regs, and that is what we will want to see. I still can imagine that you can get both the regs and the act reviewed by business before the end of the year.<sup>47</sup>

3.49 The Explanatory Memorandum provides the following explanation for the detail of the EITE assistance programme being provided in regulations:

The technical aspects of precisely defining emissions-intensive trade-exposed activities, the eligibility criteria and relevant production units, and the need for flexibility to include new activities, make the program appropriate to locate within regulations rather than the bill itself. After the detail on emissions, electricity use, revenue and/or valued added has been assessed for a given activity, the regulations will be able to provide a relatively simple allocation methodology per unit of production which provides investment certainty, minimises ongoing compliance costs and reduces the risk of assistance decisions being subject to lengthy appeal and review process which may divert resources from more important issues for business.<sup>48</sup>

3.50 The Department of Climate Change has indicated that at least some of the regulations will be available as exposure drafts before the Parliament votes on the CPRS Bills (currently anticipated before the end of June 2009):

I think the emissions-intensive trade-exposed area is the clearest example of what is happening. The intention is to release some exposure draft regulations before there is a vote—before the Senate considers the bill finally. It is unlikely to be possible to have all the emissions-intensive trade-exposed activities listed at that time, and that is essentially because there is that process going on with the affected industries about defining precisely what the activities are and then collecting audited data to feed into what the actual rates of assistance are...I think the tranches of regulations that will come through and be available at the time, plus the policy commitments that were made in the white paper, will give an indication of where that process will end up.<sup>49</sup>

### ***Committee view***

3.51 As previously noted, the Committee regards the provision of assistance to emissions-intensive trade exposed industries as appropriate to guard against the risk of carbon leakage.

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47 Ms Maria Tarrant, Business Council of Australia, *Proof Committee Hansard*, 22 May 2009, p. 25.

48 Carbon Pollution Reduction Scheme Bill 2009 *Explanatory Memorandum*, p. 119.

49 Mr Blair Comley, Deputy Secretary, Department of Climate Change, *Proof Select Committee on Climate Policy Hansard*, 20 May 2009, p. 13.



3.52 In view of the extraordinary circumstances presented by the global financial crisis, the Committee regards the expansion of assistance via the global recession buffer as prudent.

3.53 The Committee notes the assurance of the Government that at least some elements of the regulations will be available for consideration before the Senate considers the legislation, and that regulations will likely reflect the commitments of the *White Paper*.

3.54 The Committee, while recognising that it is not unusual for regulations to be formulated after a Bill is presented to Parliament, encourages the Government to make as much of the draft regulations available as soon as practicable.

### **Changes to rules on landfill**

3.55 Methane emissions arise from the decomposition of organic matter in landfill. These emissions can occur a long time after the waste was deposited in landfill – as noted by the Department of Climate Change, 'estimates [of emissions from landfill] in any year include a large component of emissions resulting from waste disposal over the preceding 50 years. This means recent changes in waste management only impact reported methane levels over time'.<sup>50</sup>

3.56 In 2006, methane emissions from solid waste disposal on land were 13.2 MT CO<sub>2</sub>e, or 2.3 per cent of net national emissions. Once waste has been disposed of to landfill, one of the few means of reducing emissions is to put in place methane gas capture (for energy generation purposes) or by flaring the emissions. In 2006, 4.6MT CO<sub>2</sub>e of methane was recovered from solid waste.

3.57 The Government's original proposal for dealing with emissions from waste deposited prior to the commencement of the scheme ('legacy waste') was to include certain special arrangements for landfill facilities. These were included in the *White Paper* and in the exposure draft of the CPRS bill. These included:

- Establishing a separate emissions liability threshold of 10,000 tonnes of CO<sub>2</sub>e for landfill facilities within a prescribed distance of other facilities (this was established to prevent 'waste displacement from covered to uncovered sites'), particularly in urban areas.<sup>51</sup> All other landfill facilities would use the scheme's standard 25,000 tonne threshold;
- Excluding all facilities which closed before 1 July 2008; and
- Excluding emissions from facilities attributable to 'legacy waste' for the period to 1 July 2018.

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50 Department of Climate Change, *National Greenhouse Gas Inventory 2006, 2008*, p. 14.

51 *White Paper*, p. 6-37.

3.58 The Government estimated in the *White Paper* that legacy emissions would fall between 30 and 60 per cent between the release of the *White Paper* and 1 July 2018. 'Excluding legacy emissions for this period will reduce the financial impact on landfill operators accordingly and will allow time to assess other abatement opportunities'.<sup>52</sup>

3.59 The waste sector raised concerns at this treatment. The Australian Landfill Owners Association (ALOA) informed the Committee during its inquiry into the exposure draft of the CPRS bills:

The inclusion of legacy waste in the CPRS (as of 2018) is the equivalent of retrospectively taxing landfill owners and their customers for waste deposited as early as 1968...Penalising landfill owners from 2018 onwards does not in any way have an impact on waste generation or waste composition modification as this waste has already been deposited...the cost of legacy waste emissions simply cannot be passed on to our current customers as a CPRS charge as the liability was created by past customers. Therefore, it will be pushed into the market as a base price increase.<sup>53</sup>

3.60 ALOA also raised ongoing concerns about methodologies used to calculate emissions from landfill.

3.61 In the bills as introduced into the Parliament, the Government has refined the treatment of emissions from landfill. The principal changes are:

- To exclude emissions from waste deposited before 1 July 2011 from being counted towards the operator's emission liability (i.e. the operator of the facility will not need to surrender emissions units for these emissions). However, legacy emissions will still be counted toward whether a facility meets the 25,000 tonne or 10,000 tonne liability threshold. The detail on how the facility's annual legacy emissions profile will be determined will be provided in regulations;<sup>54</sup> and
- To clarify that the 10,000 tonne threshold will apply to facilities within a prescribed distance of other facilities which exceed the 25,000 tonne threshold and which accept a similar classification of waste.<sup>55</sup> The distance will be prescribed in regulations.

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52 *White Paper*, p. 6-33

53 Australian Landfill Owners Association, *Submission to Senate Economics Committee inquiry into the exposure draft of the legislation to implement the Carbon Pollution Reduction Scheme (Submission 50)*, pp 2-3.

54 CPRS Bill 2009, *Explanatory Memorandum*, p. 39.

55 Department of Climate Change, 'Summary: Key Changes to the Carbon Pollution Reduction Scheme Legislation,' May 2009, p. 3, [http://www.climatechange.gov.au/emissionstrading/legislation/pubs/summary\\_changes\\_to\\_exposure\\_draft\\_bills.pdf](http://www.climatechange.gov.au/emissionstrading/legislation/pubs/summary_changes_to_exposure_draft_bills.pdf), viewed 27 May 2009.

3.62 The Government has indicated that the changes on legacy emissions was a direct response to feedback from affected stakeholders, and in particular the views of local government concerning potential impacts on ratepayers.<sup>56</sup>

3.63 The changes to treatment of landfill have been broadly supported by industry. The Australian Industry Group describing the changes as a 'victory for common sense,' whilst noting some ongoing uncertainties with regard to measurement methodologies.<sup>57</sup> The changes announced by the Government have also been welcomed by the Australian Local Government Association.<sup>58</sup>

3.64 The ALOA has also welcomed the removal of legacy waste emissions from the CPRS.<sup>59</sup> However, ALOA did note continuing concerns with regard to methodologies used under the National Greenhouse and Energy Reporting System with regard to calculation of waste emissions, but expressed satisfaction that the Department of Climate Change was responsive to these issues.<sup>60</sup>

3.65 A more significant concern was the impact of the removal of incentives for methane gas capture and energy production following the cessation of the NSW Greenhouse Gas Abatement Scheme (NGAS):

The situation today is the landfill gas operator has three sources of income. He has income coming from the landfill operator; he has income coming from the sale of the electricity itself at normal tariff rates; and he has RECs, the renewable energy certificates. That is what he has going forward... About 40 per cent of these companies' revenue comes through NGAS or through Greenhouse Friendly, so they get paid for the power; they are paid generally something from the landfill operator and they get paid for renewable energy certificates. But they will lose NGAS under the current scheme...The people who actually created this 12 per cent reduction over the last 10 years are the two companies, Energy Development Limited and LMS, and both of those that actually created all the good work are going to be penalised. Both the companies are in jeopardy because of the loss of this revenue.<sup>61</sup>

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56 Hon Greg Combet MP, Parliamentary Secretary for Climate Change, Media Release GC 03/09, 'Coverage of landfill under the CPRS', 14 May 2009

57 Ms Heather Ridout, Chief Executive, Australian Industry Group, Media Release, 'CPRS landfill waste changes a victory for common cause,' 14 May 2009.

58 Australian Local Government Association, Media Release, 'ALGA applauds removal of legacy waste from CPRS,' <http://www.alga.asn.au/newsroom/media/2009/20090514.php>, viewed 28 May 2009.

59 Mr Max Spedding, Secretary, Australian Landfill Owners Association, *Proof Committee Hansard*, 29 May 2009, p. 2.

60 Mr Max Spedding, Secretary, Australian Landfill Owners Association, *Proof Committee Hansard*, 29 May 2009, p. 16.

61 Mr Max Spedding, Secretary, Australian Landfill Owners Association, *Proof Committee Hansard*, 29 May 2009, pp 5-6.

3.66 Mr Spedding called for transitional arrangements to be put in place to cover the loss of revenue arising from the cancellation of the NGAS and similar schemes.

3.67 The committee notes that the Government has undertaken to work with the NSW and ACT Governments on arrangements for termination of the NGAS.<sup>62</sup> The Committee would encourage these discussions to be concluded swiftly, in consultation with affected stakeholders, to ensure that meaningful projects in methane gas capture and storage are not jeopardised.

3.68 The Committee commends the government for responding to the concerns raised by industry in regard to legacy waste emissions.

### **The Energy Efficiency Trust**

3.69 As part of a suite of changes to the Exposure Draft legislation announced on 4 May 2009, the Government proposed to establish a \$50.8 million Energy Efficiency Trust. Along with the Energy Efficiency Savings Pledge Fund, it forms the Australian Carbon Trust, whose stated purpose is 'to help all Australians to do their bit to reduce Australia's carbon pollution and to drive energy efficiency in commercial buildings'.

3.70 The Energy Efficiency Trust will provide funding to cover upfront capital costs for businesses seeking to undertake energy efficiency measures. Businesses would pass the cost savings back to the Trust at a commercial rate until the borrowed costs (with interest) are repaid.<sup>63</sup>

### **Other changes to the legislation affecting business**

3.71 The committee notes that the Government has made a number of other changes to the bills in response to feedback from stakeholders on the exposure draft bills.<sup>64</sup> These include clarifications of the application of the CPRS to the Joint Petroleum Development Area and Greater Sunrise Field (between Australia and Timor-Leste), technical changes to the operation of Obligation Transfer Numbers (OTNs), amendments to provisions relating to Liability Transfer Certificates and Enforcement Provisions. Although few witnesses at hearings made reference to these changes, some submissions referred to these issues.

3.72 Technical suggestions were made in relation to OTNs and Liability Transfer Certificates by BP Australia,<sup>65</sup> the Energy Supply Association of Australia,<sup>66</sup>

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62 *White Paper*, p. 15-9.

63 Once the initial capital cost has been repaid, the business keeps the ongoing cost savings from its investment.

64 Department of Climate Change, 'Summary: Key changes to the Carbon Pollution Reduction Scheme legislation,' May 2009, p. 1, [http://www.climatechange.gov.au/emissionstrading/legislation/pubs/summary\\_changes\\_to\\_exposure\\_draft\\_bills.pdf](http://www.climatechange.gov.au/emissionstrading/legislation/pubs/summary_changes_to_exposure_draft_bills.pdf), viewed 27 May 2009.

65 BP Australia, *Submission 19*, pp 3-4.

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Woodside Petroleum<sup>67</sup> and Caltex Australia.<sup>68</sup> Rio Tinto and Woodside raised a number of concerns in relation to the operation of Liability Transfer Certificates as a means of resolving liability between a controlling corporation and other entity within the corporate structure.<sup>69</sup>

3.73 ConocoPhillips expressed concern concerns that the implications of the CPRS on Timor Leste need to be more fully understood. APPEA also expressed concern about this issue.<sup>70</sup>

3.74 Leighton Holdings repeated its concern about the use of 'operational control' to determine liability for reporting emissions under the *National Greenhouse and Energy Reporting Act 2007* (NGER Act) and under the CPRS. It argued in its submission that the Liability Transfer Certificate mechanism, even as amended, does not resolve these concerns, primarily due to the timing of commencement of the CPRS bills after the first year of reporting under the NGER Act:

The mechanism to address the contract mining issue in the CPRS Bills, the Liability Transfer Certificate (LTC), is a second-best solution because parties need to resolve the 'operational control' issue under NGERS before registering under the Act by 31 August 2009 and not under the CPRS in 2011.

If mining contractors, such as Leighton Holdings' subsidiary companies, have operational control of a facility under NGERS they will therefore be the liable entity under the CPRS. Leighton Holdings will be in the invidious position of having to spend millions of dollars to set up systems, review and renegotiate contracts and collect data to meet NGERS obligations for three reporting years until there is a possibility of transferring these responsibilities using the LTC mechanism. There appears to be little gain to the Government and a significant burden to our business with this approach.<sup>71</sup>

3.75 The Committee agrees that it is desirable that the entity which is ultimately likely to have CPRS liability should be the entity which has responsibility for providing reports on emissions under the NGER Act prior to commencement of the CPRS. The Committee encourages the government to liaise further with the industry in relation to this problem.

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66 Energy Supply Association of Australia, *Submission 30*, pp 11-12.

67 Woodside Petroleum, *Submission 28*, p. 4.

68 Caltex Australia, *Submission 27*, p. 7.

69 Rio Tinto, *Submission 23*, pp 2-3; Woodside Petroleum, *Submission 28*, p. 5.

70 ConocoPhillips, *Submission 26*, p. 3; Australian Petroleum Production & Exploration Association, *Submission 33*, p. 13.

71 Leighton Holdings, *Submission 18*, pp 3-4.

