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**SUBMISSION ON ISSUES PAPER
PRIME MINISTERIAL TASK GROUP ON EMISSIONS TRADING**

This submission to the Prime Minister's Task Group on Emissions Trading is made on behalf of the plantation products and paper industry by A3P. A3P welcomes the opportunity to make a submission and congratulates the task group for the scope of topics covered in the issues paper.

SUMMARY

A3P accepts that human-induced climate change is real and requires urgent and substantive action on a large scale.

A global emissions trading scheme would be an effective component of a global response. However, there appears little likelihood that this can be achieved in the short or medium term.

At a domestic level, emissions trading, if designed well, can be more efficient than the current arrangement of conflicting and duplicative Government programs, as well as contributing towards a global response in the longer term.

Accordingly A3P supports the development and implementation of an Australian emissions trading scheme provided the international competitiveness of carbon-intensive, trade-exposed industries such as pulp & paper manufacturing can be maintained. There are a number of basic principles that should be cornerstones of a domestic scheme design:

- a) A minimum of rules that limit the choice or level of abatement options.
- b) Timeframes that are appropriate for both the required investments (40+ years) and the duration of the environmental challenge.
- c) The scope should be as broad as possible.
- d) The accounting methodology should reflect the true fate of carbon.
- e) It must be national in scope, institutions, administration, implementation and management.
- f) Other Government energy efficiency, energy reporting and greenhouse reporting programs be removed.
- g) The right to emit should exist as a secure property right.

- h) A viable quantity of permits, that cover investment timeframes, should be issued to allow transparency of price and ability to hedge risk.
- i) The scheme must be based on simple, rigorous, efficient accounting rules that minimise the cost of measurement, compliance and transactions.

There are certain design elements of an emissions trading scheme upon which the support of the plantation products and paper industry is conditional.

- j) Forestry offsets should be included in the scheme design.
- k) There should not be any artificial limitations on the amount of abatement that can be achieved through any particular means such as forestry.
- l) Carbon accounting that acknowledges that carbon remains stored in timber while it is in use and for many decades after disposal.
- m) All competing building materials (such as steel and concrete) in the domestic market must equally face the full carbon cost for emissions during their manufacture.
- n) Baselines should be set in manner that does not disadvantage early movers in the production and use of renewable energy.
- o) Other Government impediments or restrictions on the use of waste for energy production must be removed.
- p) Measures must be included to maintain the international competitiveness of carbon-intensive, trade-exposed industries, such as pulp and paper production, for as long as a viable global regime is not in place
- q) These measures should include:
 - o simple, streamlined processes
 - o stable treatment of companies, facilities and products
 - o durable rules and procedures
 - o detailed, unambiguous criteria and rules that prescribe how decisions will be made
 - o decision-making that is rigorous and fact-based
 - o decision-making and regulation through a body that has authority to make determinations but is clearly separated from Government and political influence



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BACKGROUND

A3P is the national representative body for the Australian plantation products and paper industry. A3P's 30 member companies have sales revenues of more than \$4 billion per annum and directly employ 13,500 people predominantly in rural and regional Australia in centres such as Mt Gambier, Morwell, Tumut, Albury, Oberon and Gympie.

The three sectors of A3P's membership are faced with different opportunities and threats by climate change and Governments' response including a possible emissions trading scheme.

- The pulp & paper sector is a significant user of energy, particularly in mechanical pulping processes, and is faced with strong competition from imported product from countries such as China, Brazil, Indonesia and Korea. The sector is also a producer of renewable energy using processing waste such as black liquor from chemical pulping. This renewable energy may be used on-site or exported to the grid. The pulp & paper sector used more than 50 000 TJ of energy in 2003-04 with more than 12 000 TJ produced from renewable sources on-site.
- The solid wood sector is an energy user and a potential producer of renewable energy from residues. Sawntimber stores carbon and has a significantly lower global warming potential than competing building materials.
- The plantation growing sector manages significant carbon sinks. Plantation expansion is contributing to Australia's performance against our Kyoto target and there is potential for increased activity through appropriate market responses to climate change.

The three sectors are strongly linked through supplier/customer relationships, corporate structures and market arrangements. Positive and negative impacts on one sector inevitably flow through to other sectors.

A3P members comprise 30% of the total elective participants in Australia's only current emissions trading scheme (NSW GGAS). This level of participation is the largest of any sector. A3P is therefore able draw on extensive practical experience when commenting on proposed emission trading schemes.

STATEMENT OF PROBLEM AND RESPONSE

A3P accepts that human-induced climate change is real and requires urgent and substantive action on a large scale. Further work is needed on scientific understanding and predictions but enough is currently known to justify action.

Early action will also create flexibility for future emissions paths, encourage rapid development and implementation of new technology, and reduce the cost of future action.

Emissions trading, if designed well, can be an important component of the response and will be more efficient than the current arrangement of conflicting and duplicative Government programs.

Other components of the response that would complement emissions trading include adaptation; research and development directed toward new low- or zero-emission technology; mandated performance standards; and measures for any sectors not covered by an emissions trading scheme.



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A carbon cost already exists in the Australian economy through existing schemes such as MRET, NSW GGAS, VRET, Qld 13% Gas, etc.

Much has already been done by the plantation products & paper industry, partly in response to these carbon costs, but also as part of ongoing investment and cost minimisation. The plantation products and paper industry is already a key part of Australia's response to climate change through activities such as carbon sequestration in plantations, the production of timber – a low greenhouse impact building material, reduction of energy used in processing and production of renewable energy.

A3P members have been involved in current Australian and international emissions trading schemes. This includes a number of A3P members being benchmark participants in the NSW GGAS scheme, and members with operations in countries working under the European trading scheme. This is reflected in the attachment containing short answers to the questions posed in the issues paper.

A GLOBAL SCHEME?

A global emissions trading scheme would be an effective component of a global response, enabling efficient action to be taken at the necessary speed, scale and scope.

Because of the inherent impacts on global competitiveness, the minimum definition for an effective global scheme from an Australian perspective would be a substantial proportion of global emissions and our major trading partners in emissions-intensive sectors. In effect, this will add up to most of the world's emissions anyway. There appears little likelihood that this can be achieved in the short or medium term.

Given the current situation, the only conceivable way to work towards a global scheme seems to be for Australia (and others) to take a two-pronged approach:

- (1) develop a workable domestic emissions trading scheme that deals with local circumstances; and
- (2) encourage others to do the same through international fora and link the schemes through decisions that allow the import of particular overseas permits.

Within this framework it will be important that Australia continues to participate in work on identifying international long-term targets for emissions reductions and seeks to link any domestic scheme as widely as possible with other credible emissions trading schemes.

PRINCIPLES OF EMISSIONS TRADING

If the Australian Government decided to pursue a domestic emissions trading scheme, there are a number of basic principles that should be cornerstones of the scheme design. These principles should be important to any party interested in an effective and efficient response to climate change and are not specific to the plantation products and paper industry.

- a) *Harness the power of the market* – the greatest benefit of emissions trading is the ability of the market to find the lowest cost solution. It follows from this that scheme should have a minimum of rules that limit the type or level of abatement. The underlying principle should be to treat all opportunities equally based on their mitigation impact.
- b) *Timeframes* – an emissions trading scheme should be based on timeframes that are appropriate for both the required investments (40+ years) and the



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duration of the environmental challenge. Targets and property rights should be established that are mindful of these timeframes.

- c) *Scope* – The scope of any scheme should be as broad as possible. All gases and sectors that contribute to emissions or abatement should be included. A failure to do so will increase the cost of the scheme and reduce its effectiveness. Difficulties in accounting and abatement are often overstated. There would need to be a compelling loss of efficiency (i.e., higher costs of measurement than benefits of abatement) before gases or sectors were excluded.
- d) *True fate of carbon* – The accounting methodology should reflect the true fate of carbon – emissions should be “charged” as and when they occur and sequestration should be “paid” as and when it occurs. The scheme should aim to expose producers and consumers to the true carbon cost of their decisions.
- e) *National* - An emissions trading scheme must be national in scope, institutions, administration, implementation and management.
- f) *Other government programs* - There are a range of Government energy efficiency, energy reporting and greenhouse reporting programs that have been implemented because a greenhouse market signal has not been present in the Australian economy. If a national emissions trading scheme is implemented it is vital that these other programs be removed.
- g) *Property rights* - The right to emit should exist as a secure property right. It should not be possible for the right to be diluted or removed without compensation.
- h) *Allocation* - A viable quantity of permits, that cover investment timeframes, should be issued to allow transparency of price and ability to hedge risk.
- i) *Rules and Regulations* – The scheme must be based on simple, rigorous, efficient accounting rules that minimise the cost of measurement, compliance and transactions.



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THE PLANTATION PRODUCTS AND PAPER INDUSTRY & CLIMATE CHANGE

There are four issues specific to the plantation products and paper industry which we would like to highlight to those developing Government policy responses to climate change:

1. *Sequestration in plantations and products.* The primary production component of the industry – plantation growing – is a major contributor to carbon sequestration and has the potential to make a greater contribution under the right policy settings. Plantation products retain carbon while in use and, based on recent research, for many decades after use. Long term plantation products therefore also represent a significant carbon sink.
2. *Greenhouse friendly building material.* International studies, including those by the National Council for Air and Stream Improvement (NCASI) in USA, have demonstrated that timber has lower levels of embodied energy and a lower greenhouse footprint than other building materials.
3. *Renewable Energy Use.* The processing sectors of the industry – sawmilling, pulp and paper – already have high levels of renewable energy use, including the production, and export to the grid, of electricity generated from wood residues and the by-products of chemical pulping (black liquor).

There is also significant potential for increased renewable energy production from plantation wood.

4. *Carbon-intensive, trade-exposed.* The pulp & paper sector particularly is a large user of energy and despite high levels of renewable energy use is relatively carbon-intensive. The sector also faces intense competition from suppliers in countries with lower environmental standards and little likelihood of introducing a carbon cost, such as China, Brazil, Indonesia and Korea. The impact of an Australian carbon cost on the competitiveness of the pulp & paper sector is a major concern.

Points 2 and 4 above are a specific example of a conundrum that faces the designers of a policy response to climate change, in the absence of a truly global response.

The introduction of a carbon cost will change the relative competitiveness of competing products or services on the basis of their emissions profile. This is central to the objective of the policy and must be allowed to occur. It creates the market signal that brings about the behavioral change needed to reduce emissions.

However, the introduction of a carbon cost in some countries and not others will change the competitiveness between products based on their country of origin, not their emissions profile. This is contrary to the policy objective, damaging to the economy, and will not lead to reductions in emissions. Measures should be implemented to minimise or eradicate this effect.

The challenge to policy makers is to design a response that allows the former outcome but prevents the latter. In the context of the plantation products and paper industry, it must reward the lower greenhouse footprint of timber compared to competing building materials but not reduce the competitiveness of Australian pulp & paper producers relative to producers in countries with no carbon cost.

IMPLICATIONS FOR EMISSIONS TRADING

It follows from the four specific issues highlighted above that there are certain design elements of an emissions trading scheme that are crucial to the plantation products and paper industry. These are not requests for special treatment but areas where the policy must closely align with the real climate change impacts of behavior so that perverse incentives or distortions are not created. Other examples of greenhouse policy including the European Emissions Trading Scheme and the NSW Greenhouse Gas Abatement Scheme have not always effectively addressed these issues.

1. *Sequestration in plantations and products.* Ensuring that the carbon stored in plantations and plantation products is appropriately accounted for in an emissions trading scheme suggests the following high-level design elements:
 - j) Forestry offsets should be included in the scheme design.
 - k) There should not be any artificial limitations on the amount of abatement that can be achieved through any particular means such as forestry.
2. *Greenhouse friendly building material.* An emissions trading scheme will provide a clearer carbon price signal and lead to more abatement if it has the following design elements:
 - l) Carbon accounting that acknowledges that carbon remains stored in timber while it is in use and for many decades after disposal - this brings the carbon storage up to the 100-year threshold often used as a surrogate for permanence.



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- m) All competing building materials (such as steel and concrete) in the domestic market must equally face the full carbon cost for emissions during their manufacture. Any measures to address the international competitiveness of these sectors must not negate the carbon market signal in the domestic building market.
3. *Renewable Energy Use.* Renewable energy production and use will be an important part of a response to climate change.
- n) Baselines should be set in manner that does not disadvantage early movers in the production and use of renewable energy.
- o) Other Government impediments or restrictions on the use of waste for energy production must be removed.
4. *Carbon-intensive, trade-exposed.* Given that an effective global regime is unlikely in the short or medium term, and there are strong arguments for commencing action sooner rather than later in Australia, the following design elements should be incorporated in any domestic scheme:
- p) Measures must be included to maintain the international competitiveness of carbon-intensive, trade-exposed industries, such as pulp and paper production, for as long as a viable global regime is not in place
- q) These measures should include:
- simple, streamlined processes
 - stable treatment of companies, facilities and products
 - durable rules and procedures
 - detailed, unambiguous criteria and rules that prescribe how decisions will be made
 - decision-making that is rigorous and fact-based
 - decision-making and regulation through a body that has authority to make determinations but is clearly separated from Government and political influence

Three types of measures are often proposed as methods of maintaining international competitiveness.

Exemption – exempt trade exposed industry from obligations under the scheme.

Free allocation – partial free allocation of permits to carbon-intensive, trade-exposed industry to offset increased production costs.

Border measures – rebates of increased costs for exports, and tariffs on imports.

Exemption is difficult in practice, if not impossible, given that emissions and increased costs occur predominantly within the energy sector rather than the manufacturing sector. Free allocation has the drawback that it is likely to neutralise the desired impact on, for example, building materials in that it would offset any increased costs for steel and concrete relative to timber.

Border measures appear to most effectively address the problem and minimise collateral damage. However there is an enormous level of sovereign risk associated with whether such an approach would be durable under World Trade Organisation rules or could feasibly be negotiated internationally. There is a strong case to

explore this option further and either identify what would need to change internationally to make it feasible, or definitively rule it out as an option.

No-one has yet shown how to maintain the competitiveness of carbon-intensive, trade-exposed industries in a way that is effective, durable (particularly with respect to WTO), free of political interference, simple, stable and predictable.

If a measure cannot be identified that meets the criteria outlined above, the best available alternative may be a single payment or allocation of permits to offset the expected loss in future profits from the introduction of an emissions trading scheme. After this, all the economy would be exposed to the carbon cost.

The disadvantages of such an approach are that it may effectively (over) compensate industry for a future time when an effective global scheme is in place and that it does not address loss of competitiveness for new investments.

However, an effective global scheme is highly unlikely to be in place for at least 20 years. This is similar to the expected life of many existing assets and even the payback period for proposed new assets. Furthermore, the net present value of any lost profit is negligible over timeframes longer than 20 years.

The competitiveness of potential new investments in carbon-intensive, trade-exposed industry is more difficult to address. It may be possible for these new investments to be 'protected' through some of the funds raised through the scheme.

It would appear that the task of introducing a carbon cost to the Australian economy without disadvantaging a large component of the existing manufacturing industry is the most significant challenge in the development of policy on climate change mitigation.

Short responses to each of the questions posed in the Issues Paper are provided as an attachment. Thank you for the opportunity of providing comment. A3P would appreciate the opportunity to participate in processes that develop further detail. If you have any questions please contact Miles Prosser on 02 6273 8111 or miles.prosser@a3p.asn.au

Yours sincerely



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Context Setting

1. What are the implications for Australia of a carbon constrained future?

- Higher energy costs.
- Loss of competitive advantage for carbon-intensive, trade-exposed industries.
- Increased production and use of bioenergy – potentially creating competition with food and fibre production.

2. What are the elements likely to affect the cost of reducing emissions over time and how might these develop?

- The size and timeframe of targets will be a major factor effecting costs.
- Costs will be reduced if the scheme design is efficient – e.g., broad scope, allowing offsets, appropriate timeframes, secure property rights, etc.
- Costs and rates of implementation of clean coal technology.
- Rate of reduction in wind/solar costs.
- Feasibility of other low-emission alternatives – geothermal and nuclear.
- Rate of economic growth – this would tend to increase emission levels but also allows capital investment that can reduce emissions.
- Ability to align other policy programs to assist emission reductions (revegetation, energy efficiency, energy market reform, energy security, etc).

3. To what extent is Australian industry currently factoring a carbon price into investment decisions? How can longer term investment certainty be improved?

- Programs such as MRET, NSW GGAS, etc already impose a carbon price.
- Energy-producing and energy-using industries are both factoring carbon prices into long term investment decisions (5 years +) as scenarios or sensitivity analysis.
- Greater clarity of the future policy environment, particularly the shape and rules of an emissions trading scheme, would increase certainty. But there will still be uncertainty over future price and policy changes.
- However, if emissions trading is implemented AND a viable quantity of permits released that cover investment timeframes, then a futures market can be established. This allows both transparency in likely future price and the ability to hedge to reduce risk.
- Government can't provide certainty but can develop policy that allows certainty to be managed.



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A workable global emissions trading scheme

1. What would constitute a workable global emissions trading scheme from Australia's perspective? It would be useful if respondents could reflect on the key principles, design elements and objectives underlying such a scheme:
 - a. how to best protect Australia's economic competitiveness?
 - A truly global scheme that covers all gases, all sources and all sinks.
 - Minimal transaction costs – a single system
 - Particularly important to include sources/sinks that are significant in Australia such as LULUCF.
 - Differentiated targets that reflect Australia's natural resources and current industry structure.
 - b. how encompassing? What constitutes an effective definition of "global" (ie does this include all countries, major emitters only, Australia's major trading partners or competitors in key sectors)?
 - Clearly, more countries would be better.
 - Minimum definition would be major trading partners in emissions-intensive sectors. This will add up to most of the world's emissions anyway.
 - c. what scope? which greenhouse gases should be included and which sectors (or industries) covered?
 - For scope, gases and sectors, wider is almost always better as it increases the range of options, reducing the costs.
 - It is better to err on the side of inclusion rather than exclusion.
 - There would need to be a compelling loss of efficiency (i.e., higher costs of measurement than benefits of abatement) before gases or sectors were excluded.
 - Difficulties in accounting are often overstated and in reality are not a significant impediment.
 - It is important that significant emitting sectors such as transport and agriculture are included.
 - d. how should permits be issued or allocated and offset creation be administered?
 - Permits should be allocated based on each country's cap/target.
 - Each national Government should manage their own permit allocation.
 - Offset creation should be based on a simple set of international principles with detailed implementation at a national level.
 - e. how to ensure market transparency through registry and information systems, monitoring and compliance?
 - Robust, transparent information on price is important for investment certainty.
 - Simple, accessible systems are needed.



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f. [what financial market support structures need to be established?](#)

- There must be an ability to trade in future permits to create transparency of price
- There may be a case for an “official” exchange if commercial exchanges prove reluctant to list the permits – though this seems unlikely.

g. [what other key design elements are required?](#)

- Minimal limitations on type of abatement. Any carbon is equivalent. Policy makers should avoid clouding the issue with other policy objectives.
- An ability to bank abatement for future periods will enhance flexibility without reducing environmental effectiveness.

2. [How have existing emissions trading schemes delivered against key desirable design elements? What problems have emerged?](#)

European scheme

- The largest existing scheme is the European emissions trading scheme (EU ETS). Members of A3P have experience direct experience of the EU ETS due to having operations in European countries where the scheme operates. There are a number of key design issues and emerging problems in respect to the EU ETS that are of concern.
- The scheme hasn't guarded against a loss of competitiveness between those inside the scheme and those outside the scheme.
- Too many restrictions – market not free and liquid.
- The price of carbon under the scheme has undergone dramatic fluctuation. Leading up to the scheme, the consensus was prices of CO₂ would be around 5 to 7 Euros per tonne. In the first phase of the scheme, starting in early 2005, the price quickly climbed to 15 Eur/t, peaked at 30 Eur/t in early 2006 shortly before dropping below 10 Eur/t. The price for these 2007 allowances is currently around 1 Eur/t.
- The scheme has resulted in significant transfer of wealth from consumers and manufacturing to energy suppliers unrelated to emissions abatement. Industrial consumers have paid an inflated electricity price, as the cost of CO₂ has been built into every MWh of electricity consumed by industry, however the generators have been allocated free credits for a significant proportion of their emissions. This has led to a windfall profits for generators that has nothing to do with emissions reduction¹.
- Limited real abatement beyond business as usual for the cost incurred. The scheme has not led to least cost abatement, largely due to the above point.
- It is possible that the policy goals could have been achieved at a lower cost. The EU ETS has not directly resulted in the development of new renewable energy industries. Additional policy instruments have been



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¹ [“Power intensive industries object to windfall profits from Emissions Trading”](#) 20 February 2004. In this release the European associations representing energy intensive industries put their case why an Emissions Trading Scheme would result in reducing the competitiveness of their industries by unjustifiably increasing the price of electricity and creating windfall profits for the generators.

required to encourage, for example, the development of wind energy in Germany² and promotion of biomass use in the EU³. It is arguable whether the EU ETS was even necessary to achieve these aims.

- The European Union has been unsuccessful in curbing unfair exercise of market power by the big players.
- No inclusion of forestry offsets.
- Complicated by other Government policies on renewable energy.
- Not sufficiently long-term to provide investment certainty.

MRET

- Limits choice of abatement options.
- Expensive.
- Market impacts are wider are larger than benefits.

NSW GGAS

- Timeframe too short.
- Narrow sectoral coverage.

3. Does the inclusion and design of a global emissions trading scheme have implications for the broader international climate change framework?

- If a global emissions trading scheme was implemented it would need to be a central part of an international climate change framework.
- But the international climate change framework would also need to deal with adaptation, improved scientific understanding, developing new technology (R&D), etc.

4. What would be the best way to design a workable global scheme to encourage maximum participation at the outset? In particular, would an accession mechanism, an incentive, or flexibility in the form of commitments, be needed to allow additional countries to be brought into the system more fully over time? If yes, what are the key design elements?

- Given the current situation, the only conceivable way to achieve a workable global scheme seems to be for Australia (and others) to take a two-pronged approach: (1) develop a workable domestic emissions trading scheme that deals with local circumstances and (2) encourage others to do the same through international fora and link the schemes through decisions that allow the import of particular overseas permits.

5. What are the possible advantages and disadvantages to Australia of being positioned within the first-wave of countries to adopt emissions trading as a step towards a workable global scheme?

- Given the implementation of the European Emissions Trading Scheme, we aren't in the first wave.
- Advantages of moving sooner – understand emissions, commence process of change, investment in abatement sectors, industry adapts

² Lucy Butler and Karsten Neuhoff: [Comparison of Feed-In Tariff, Quota and Auction Mechanisms to Support Wind Power Development. Cambridge Working Papers in Economics CWPE 0503, 2004.](#)

³ “[Biomass action plan](#)” 7 December 2005. Commission of the European Communities.



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early to carbon constraints, import low cost abatement from overseas, phase out inefficient existing schemes.

- Disadvantages of moving sooner – loss of competitiveness, restructuring of industry caused by changed international competitiveness that does not reduce global emissions.



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Domestic action to prepare for a workable global scheme

1. How is Australia positioned to respond to or influence any emerging workable global scheme? Respondents could reflect on whether:

a. the appropriate systems are available for greenhouse reporting and measurement?

- Both corporate and government systems for reporting and measurement are well developed.
- There would need to be a substantial effort put into removing duplicative systems to reduce the measurement and reporting burden.
- A registry system would provide transparency, although means of reducing the cost of information retrieval should be explored.
- A more important issue is curbing unfair exercise of market power by the big players. The European institutions have been unsuccessful in dealing with this issue.

b. financial markets are able to provide relevant instruments for trading?

- A3P has no particular knowledge in this area but presumably the required instruments are not greatly different to some already traded – RECs, NGACs, futures, etc.

c. other relevant issues?

- Australian policy-makers have shown a good understanding of the impacts of greenhouse policy on the economy.
- Our situation as a developed country with relatively small domestic markets and located within a region of rapidly expanding demand and production is unique.
- Both the above points make the Australian position highly relevant to the design of any global scheme.

2. What are the pros and cons of Australia adopting a domestic emissions trading scheme in the absence of a universal, fully-developed international scheme? It would be useful if respondents could reflect on:

a. the impact on global abatement efforts;

- In quantitative terms the impact on global emissions will be minimal.
- Given Australia's previous policy position the leadership/positioning impact may be significant

b. the implications for Australia's international competitiveness;

- If linked internationally, those sectors with abatement opportunities would gain access to significant potential funding.

- The implications for the international competitiveness of energy-intensive, trade-exposed industry are a critical issue.
- Energy costs will rise. Where this is a significant part of total production costs, the competitiveness of Australian producers will reduce.
- This will have a gradual but consistent impact on Australian industry as the following occurs: loss of markets to overseas producers, reduced profitability from Australian production, shifting of upgrade investments away from Australia to overseas, shifting of greenfields industrial investments away from Australia to overseas, gradual decline in Australian production levels.
- The pulp & paper sector is a classic example where imposing a carbon cost in Australia may lead over time to a loss of markets, production and investment to other countries - a shift that would damage the industry and economy in Australia but unlikely to reduce global emissions. Most of the countries that Australian producers compete against in local and export markets are not likely to impose a carbon cost in the near future – e.g., China, Indonesia, Brazil and Korea.
- This issue of international competitiveness of energy-intensive, trade-exposed industry has been treated seriously in recent discussions on emissions trading. One solution proposed is that these industries would receive a partial allocation of free permits, designed to offset the expected increase in costs, thereby maintaining competitiveness.
- This solution may address the competitiveness issue for the pulp & paper sector. However, it would also immunise steel and concrete from extra costs compared to sawntimber.
- There are two impacts on competitive forces potentially created. The first is between competing products with different emissions profiles. The impact on relative price of the products is exactly the type of price signal that emissions trading is intended to create to change behaviour and reduce emissions. The second is an impact on international competition between countries that impose a carbon cost and countries that don't. This impact is unwanted as it does not fulfill the policy objective – reducing emissions – and damages the domestic economy.
- The objective would be best served by a policy that maintained the international competitiveness of energy-using industries in Australia but changed the relative competitiveness of products in favour of those with low emission profiles, such as timber.
- A possible solution is to allow the full force of carbon price signals within Australia, but deal with international competitiveness for imports and exports at the border.
- These objectives suggest that some form of border control measure (a carbon tariff on imports and/or carbon refund for exports) would more be more effective than free permits in changing consumer behaviour. Though there will be many legal, definitional and operational issues around such a measure.



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- Any mechanisms to address competitiveness must be devoid of any fear that they would breach WTO, free trade agreements, etc.
- They must also be free of political interference or erosion over time as well as simple and predictable.
- No-one has yet shown how to maintain the competitiveness of energy-intensive, trade-exposed industries in a way that is effective, durable (particularly with respect to WTO), free of political interference, simple, stable and predictable.
- Until this can be demonstrated the introduction of a domestic scheme in the absence of a global scheme will reduce the competitiveness of key industries.

c. [the implications for industry performance;](#)

- See above for impacts on energy-intensive, trade-exposed industries.
- Other sectors will benefit, particularly those with significant abatement opportunities.

d. [the extent to which a domestic scheme would promote investment generally and in low emissions technologies in particular;](#)

- Some investment in abatement would occur.
- The extent of investment in abatement will depend on the timeframe and level of the target and whether the scheme is linked internationally.
- Investment in energy-using industries would be reduced – including investments that may otherwise have reduced emissions.

e. [whether transitional measures would be necessary to protect Australia's *existing* competitive advantages;](#)

- Transitional measures will be required to protect Australia's existing competitive advantage in carbon-intensive trade-exposed industries.
- The transitional measures to maintain international competitiveness should include:
 - simple, streamlined processes
 - stable treatment of companies, facilities and products
 - durable rules and procedures
 - detailed, unambiguous criteria and rules that prescribe how decisions will be made
 - decision-making that is rigorous and fact-based
 - decision-making and regulation through a body that has authority to make determinations but is clearly separated from Government and political influence
- The availability of transitional measures should be assessed at a facility (plant) level due to the many variations in product, process, markets, price and international competition.



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- The specific nature of the measures to maintain competitiveness will be important, including the criteria for qualification and the means for determining if and when the measures should cease

f. whether the early introduction of a domestic trading scheme might promote the emergence of *future* competitive advantages for Australia;

- Those sectors that will benefit from emissions trading would also probably benefit more from early introduction.
- It would hasten the natural selection of those industries/firms that will be successful under carbon constraints.
- But, early introduction may lead to a loss of investment and markets that is not justified by any reduction in global emissions

g. the efficacy of a domestic emissions trading scheme in achieving policy objectives relative to alternative or complementary measures;

- Emissions trading will be effective in implementing currently available, least-cost abatement opportunities.
- Emissions trading is more effective than measures where Governments pick preferred methods of abatement.
- However, there would also need to be measures to develop new technology - emissions trading alone will not be sufficient. The new technology will be essential to achieve the level of emissions reduction that will be required in the long term.

h. the opportunity for Australia to design a flexible scheme which would allow the country to calibrate its commitments in response to international developments.

- A measured implementation of any domestic scheme will be desirable to maintain international competitiveness.
- However flexibility also translates into uncertainty and the potential for major policy changes at short notice.
- There must be careful construction of any staged implementation or flexibility to ensure that the intended certainty is not eroded.
- A viable quantity of long-dated permits with secure property rights should be issued to enable the establishment of markets, price transparency and the ability to hedge risk.
- The “gateways” approach to setting targets is an example of providing flexibility without undermining certainty.

3. What are the key design features (such as permit allocation, offsets and coverage) of a workable domestic scheme?

- The scheme should be as broad as possible, covering all emissions and all abatement and sequestration opportunities, including forestry offsets.
- There should be a minimum of rules that restrict the type of actions that are pursued. Allow the market freedom to find the least cost.
- There should be few or no limitations on the ability to bank abatement for future periods.



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- The right to emit must take the form of a legally enforceable, compensable property right.
- Targets set over long timeframes that are appropriate to both the nature of the problem and the longevity of investments. Consider use of gateways to manage target setting in the face of uncertain knowledge.
- Other Government programs that favour particular abatement opportunities should be removed, as should energy efficiency and greenhouse/energy reporting programs to reduce costs.
- Accounting methodology should reflect the true fate of carbon – emissions should be “charged” as and when they occur and sequestration should be “paid” as and when it occurs. Carbon retained in timber products should be credited.
- The scheme should aim to expose producers and consumers to the true carbon cost of their decisions. For example, producers and consumers of rival products for the domestic market should face the true carbon cost of their options.
- The scheme should minimise the extent of distortions that do not fulfill the policy objective. It should include measures to maintain international competitiveness of energy-intensive, trade-exposed industries.
- An emissions trading scheme must be national in scope, institutions, administration, implementation and management.
- The design of any proposed scheme should be informed by thorough economic analysis including its potentially significant impact at a sectoral and regional level within the economy.

4. What other steps could Australia take:

- a. to prepare for any workable global scheme?
- b. to improve energy efficiency in end uses, including through better demand management and the facilitation of future technological improvements?
- c. to encourage the commercial deployment, in Australia and overseas, of low emissions technology?
 - If a carbon cost is to be imposed, a well-designed emission trading scheme is the appropriate method.
 - It is important that it not be obscured or complicated by other measures seeking to address the same policy objective.
 - Other measures should only be pursued if they have justifications outside the effectiveness of emissions trading, e.g., energy efficiency may be justified to reduce required investment in transmission. R&D into low-emissions technology may be necessary for longer term reduction that will not be pulled through by emissions trading alone.

5. Are the proposals put forward in 4(a)-(c) best considered as complements to a domestic trading scheme or as an alternative?

- Covered in answer above. Domestic trading is the best option for a carbon cost. Other options are (inferior) alternatives and should not be introduced as complements.



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Other Measures

1. Were Australia to adopt an emissions trading scheme what would be the implications for the current suite of measures to address climate change?
 - a. would emissions trading further encourage the research and development of low emission technologies?
 - Emissions trading would only be a weak factor for pulling through long term R&D due to difficulties in recovering the value of the R&D investment from the market.
 - b. would emissions trading have an impact on the commercial deployment of other low emissions technologies?
 - Well designed emissions trading should be effective in the commercial deployment of an appropriate amount and type of existing low emissions technology.
 - There is a risk of over-investment in expensive short term abatement.
 - c. would emissions trading have an impact on the take-up of low cost abatement options such as energy efficiency measures?
 - Well designed emissions trading should be effective in the appropriate amount and type of low cost abatement. Existing energy efficiency measures should be reviewed and removed unless there was a compelling justification for their retention not related to emissions reduction.
 - d. would there be scope to abolish other, more costly, interventions without affecting the overall abatement effort?
 - Yes, by definition. If the other measures are more costly then emissions trading could achieve the same outcome more efficiently by appropriately setting the target. The other measures should therefore be abolished.
 - e. what other policies would most effectively complement a possible future emissions trading system?
 - Investment in R&D on a broad range of potential new technologies.
 - Mandated performance standards.
 - Improved scientific understanding.
 - Adaptation to climate change.
 - Measures to address sectors not covered by emissions trading – though the best option is for all relevant sectors to be covered.
2. What low cost abatement options are available now? How technically feasible is it that existing infrastructure, plant and equipment can be modified to reduce emissions?
 - Significant energy users (and therefore emitters) already have incentives to minimise their energy use. The implementation of a (higher) carbon cost will change the economics at the margin, making some currently marginal projects more viable.



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- The greatest increases in energy efficiency, or reductions in greenhouse emissions, will be achieved by investment in new plant and equipment rather than modifications of existing infrastructure.
- Policies that increase the rate of reinvestment of capital will benefit emissions reduction. Similarly, positive economic and market conditions will increase the likelihood that investments are made and emissions reduced.

3. To what extent would emissions trading facilitate such abatement or modification activities?

- The implementation of a (higher) carbon cost will change the economics at the margin, making some currently marginal projects more viable. The size of the impact is directly linked to the magnitude of the carbon cost, which in turn is linked to the target.
- However the magnitude of negative impacts including unwanted industry restructuring is also linked to the carbon cost and the target.



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