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**SUBMISSION TO 'TREATMENT OF ELECTRICITY-INTENSIVE, TRADE-EXPOSED
INDUSTRIES UNDER THE EXPANDED NATIONAL RENEWABLE ENERGY TARGET
SCHEME' DISCUSSION PAPER**

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This submission has been prepared on behalf of the plantation products and paper industry by A3P. A3P appreciates the opportunity to make a submission.

A3P's major interest relates to the impact of increased costs associated with the expanded Renewable Energy Target (RET) Scheme on the pulp & paper industry; accordingly this submission focuses on the RET affected trade exposed (RATE) Discussion Paper and the specific situation of the Australian pulp & paper industry.

However, A3P has fundamental concerns regarding the transition from the Mandatory Renewable Energy Target (MRET) to the RET and the enormity of the increase in the target between the two schemes. A3P is a member of AIGN, whose submissions examine these issues from a whole-of-industry perspective:

- The RET target of 20% renewable electricity by 2020, is a massive expansion that cannot be disguised as an incremental increase on MRET. The more affordable renewable energy options (e.g. incremental expansion of hydro electricity) have been exhausted and the level of renewable electricity generation is required to increase dramatically in a short time. The scheme will involve costs that are orders of magnitude higher than MRET, at a time when the Carbon Pollution Reduction Scheme (CPRS) will also push up the price of electricity by requiring permits to be purchased for greenhouse gas emissions in covered sectors.
- The design of the RET makes it unlikely that the scheme will encourage industry development through the sustainable expansion of a range of renewable energy technologies. A market-based, temporary measure such as this creates the risk that technologies which are easy to deploy quickly will be favoured (primarily wind energy); these facilities may well require a continuation of subsidies, or shut down, as the RET is phased out.

Introduction

A3P is the national representative body for the Australian plantation products and paper industry. The three sectors of A3P's membership are faced with different opportunities and challenges in the area of renewable energy. The pulp & paper sector is a significant user of energy – both grid-purchased electricity and energy produced on-site from fossil fuel and renewable sources. The solid wood sector is also an energy user and produces renewable energy from residues. Harvest residues from plantations are a valuable biomass feedstock, and the plantation growing sector could potentially expand to include purpose-grown energy crops. The three sectors are strongly linked; positive and negative impacts on one sector inevitably flow through to other sectors. Further information on the opportunities and challenges of renewable energy to A3P's members can be found at *Attachment A* to this submission.



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Trade-exposed, electricity-intensive (RATE) industries

The impact of increased domestic costs (a carbon cost or a renewable energy cost) on domestic energy users, where those users are exposed to strong international competition and unable to pass on cost increases to customers, has been well debated and explored in the development of emissions trading and renewable energy policy.

The key issues are:

- o the magnitude of the cost impact;
- o the ability of firms to pass on the costs to customers;
- o the ability of firms to absorb costs that cannot be passed on; and
- o the materiality of the resultant impact on profitability, investment and employment.

The Discussion Paper indicates that the Government is considering including measures to address these issues in the RET Scheme. A failure to do so would inevitably lead to a loss of existing and potential investment in these industries. While the scheme may achieve its objective of increasing renewable electricity generation, it would come at a cost to the Australian economy by shifting production off-shore.

The RET Scheme must include measures to offset the loss of competitiveness of RATE industries as it will unquestionably increase the cost of domestic electricity.

The Discussion Paper cites a stakeholder view that wholesale electricity prices may fall as a result of the early availability of large amounts of low short-run marginal cost generation (wind) under the RET Scheme. This view is presented with no supporting information. A3P finds it difficult to believe that such an outcome would occur. At best it would slightly increase competition in the RECs market; at worst it would result in a sharp decline in investment in renewable capacity after the early years of the Scheme due to the limited market for RECs (which could potentially be crowded by these early entrants).

Combined impact of CPRS and RET

Consultation processes on the RET and the CPRS have been kept entirely separate; it appears that measures to address impacts on the competitiveness of RATE and EITE industries are being developed in isolation from each other. This is

illogical given that the two schemes will have a cumulative impact on the economy, on industries and on individual businesses and facilities. When the impact of both schemes is considered, especially on trade-exposed firms that have limited or no ability to pass on increased costs, it becomes evident that the *combined* impact of the CPRS and RET is very substantial. A3P feels this issue has not been given enough consideration to date.

When taking account of the CPRS and the RET together, a number of issues come to light:

- Over the life of the RET, firms will be required to purchase increasing numbers of RECs in the market. This cannot be compared to current obligations because of the sheer scale of the new target of 20% renewable electricity by 2020 (almost five times the current target).
- It is unclear whether new renewable electricity will be 'supported' under the CPRS (i.e. if the EITE electricity factor will continue to apply to all electricity use, regardless of source, as more renewable electricity comes online).
- At the same time as the amount of renewable electricity use (and obligation to purchase RECS) is increasing, the level of permit allocation to EITEs under the CPRS will decay at 1.3% per annum. This translates to compounded escalating costs due to higher rates of renewable electricity generation *and* the effect of waning permit allocation.
- These massive increases in operational costs will consume capital that could otherwise be used to fund improvements in carbon productivity. This will become a vicious cycle as domestic manufacturing costs increase and the competitiveness of Australian trade exposed products declines.

Preliminary figures reveal that the combined impact of the CPRS (with EITE assistance) and the RET (without RATE assistance) on the pulp & paper industry could be in the order of 25% - 30% of earnings before interest and taxes (EBIT) by 2020. Such a significant impact would render many efficient, world-class Australian pulp & paper manufacturing facilities unprofitable against operations that are not subject to carbon costs and renewable electricity policies.

The financial impacts of the CPRS and RET schemes, especially on trade-exposed industries, are serious and should be considered together. There is a strong case for "embedding", or integrating, the process for determining eligibility for assistance under the two schemes as their objectives and impacts are very similar.

Assistance to RATE industries

The Discussion Paper considers assessing eligible activities for the RATE measure, citing an electricity intensity threshold of 5000Mwh per \$million revenue. This figure is entirely arbitrary and is not supported by analysis, or accompanied by grounds for proposing such a high threshold. A3P notes that the data provided in the table at Attachment A is on an industry, not an activity, basis. As it is proposed that the RATE measure be applied on an activity basis, this table has limited usefulness as it conceals a degree of variability in electricity intensity within industries. The apparent gap in electricity intensity between aluminium and all other electricity-intensive industries is chiefly an artefact of the classifications, which conceal higher levels of electricity intensity within these categories.



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Furthermore the accuracy of the figures in this table is questionable – the electricity usage and costs attributed to the pulp & paper industry is well below that of A3P's pulp & paper members alone. While activities other than aluminium refining may not consume as large a percentage of Australia's electricity, electricity is nonetheless a substantial input (and cost). An increase in electricity costs by an artificial RECs market will also threaten the competitiveness, and the future, of pulp & paper and other industries.

The threshold alluded to appears designed to limit the RATE measure to only a few of the highest electricity-intensive activities. Additionally it is the level of trade-exposure of an activity that will determine its inability to pass on increased costs.

If an electricity intensity threshold is the preferred method of implementing the RATE measure, then it needs to be set taking account of the purpose of the measure, which is to prevent the increased costs, created by the RET Scheme, from causing losses in competitiveness that compel firms to move their operations offshore. This at the very least should require the electricity intensity threshold to be lowered. Such considerations led to the proposed NSW renewable electricity scheme indicating that the pulp & paper industry would be appraised for exemption.

The criteria for qualifying for the RATE measure should not be based on an arbitrary and artificially high electricity intensity threshold. The criteria should genuinely reflect the measure's objective of avoiding cost increases associated with the RET Scheme from causing leakage in trade-exposed industries.

The CPRS and the RET both have objectives related to reducing greenhouse gas emissions. This seems to be a duplicative approach and there is a strong view in Australian industry that these schemes should not coexist because they will increase the cost of abatement. The CPRS is broader in nature, and should therefore be a more efficient means of achieving lower cost emissions reductions.

However if both schemes are being introduced it would be wise to consider the similarities between EITE and RATE industries or activities. It would make sense to align measures for industries qualifying under EITE and RATE because the same rationale for assistance applies to both.

The RATE measure should be modelled on the EITE measure and include a number of electricity intensity thresholds (rather than one extremely high threshold). The similarity between the rationales for EITE and RATE measures could justify a model to assess the cumulative impact of the CPRS and the RET to determine the need for assistance under both schemes.

Mode of assistance to RATE activities

It would be efficient to align any process of offsetting competitive loss of RATE industries/activities with the CPRS's package to provide transitional support to EITE industries/activities. There are obvious parallels in the objective of measures for RATE and EITE industries, and the provision, by firms, of information to Government could be streamlined by designing the two measures in a similar way.

The Discussion Paper outlines several options for the treatment of RATE industries:



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Option 1: No assistance

Given the strong arguments in favour of putting in place a measure for RATE industries, and in view of their inability (or limited ability) to pass on cost increases related to the price of domestic electricity, A3P considers that providing no assistance is an unviable option. The argument that this would be consistent with MRET is not supported by any justification – it is unclear why consistency with MRET is desirable. It is also important to remember that the RET Scheme sets a much larger target than exists under MRET.

Option 2: Exemptions

A3P agrees that this option would be administratively simple and therefore attractive to both industry and Government.

Option 3: Free issue of RECs

The issue of RECs would have a direct link to the impact of the RET and be consistent with the EITE measure, which would make the administrative obligations for firms with liabilities under both schemes more straightforward and manageable.

Option 4: Cash payments

The benefit of this approach is transparency, however the link between REC prices and scheme obligations would be broken, thereby creating complexities in the allocation of cash payments.

A3P supports either Option 2 or Option 3, with Option 2 being preferred. These measures have a direct link to the impact of the RET Scheme and firms' liability to acquit RECs.

Level of support to RATE activities

The level of support to RATE activities should be determined by the objective of the measure. The Discussion Paper rightly points out that the higher the level of support, the more likely RATE activities are to be able to maintain their operations in Australia. The RET Scheme creates an increase in costs which is unlikely to be equalled in competitor economies through similar policies. Therefore there is a case to be made for the RATE measure to continue for the life of the RET Scheme because the threat of leakage is unlikely to diminish.

A3P supports the continuance of the RATE measure, commensurate with the level of compliance obligations under the RET, for the life of the Scheme.

It has been suggested that the electricity factor in the CPRS EITE measure is generous and should do something to ameliorate the impact of the RET on EITE industries/activities. There are serious fallacies to this line of reasoning.

The setting of the electricity factor was a policy decision based on containing the risk of carbon leakage. The EITE measure has been designed based purely on the impact that the carbon market will have on trade-exposed and emissions-intensive activities. This ignores the reality that the CPRS and the RET will have a *cumulative impact* on trade-exposed industries; if an affected industry receives support under only one scheme, the other will still have the detrimental impacts of carbon and job leakage that the EITE and RATE measures are seeking to address. Providing transitional assistance under the CPRS does not acknowledge that firms will also bear a cost burden due to the obligation to purchase and acquit RECs. If a RATE measure is not offered to such activities, this will effectively erode the objective of the EITE measure.



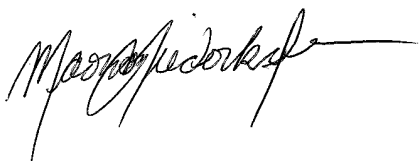
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In setting the level of support for RATE activities, the cumulative impact of the CPRS and the RET on emissions/electricity-intensive, trade-exposed industries should be assessed together and not in isolation.

Thank you for accepting our comments on the RATE Discussion Paper. A3P would appreciate the opportunity to participate in further consultations and discussions. If you have any questions please contact Marion Niederkofler on 02 6273 8111 or at marion.niederkofler@a3p.asn.au

Yours sincerely



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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. A3P represents the largest and fastest growing sectors of the forest industry – plantation growing, sawntimber production (from plantations) and paper manufacturing (from plantations and recycled fibre). A list of A3P members and statistics on their operations is available from the A3P website:

www.a3p.asn.au.

The Australian plantation products & paper industry and renewable energy

The three sectors of A3P's membership are faced with different opportunities and threats in the area of renewable energy production and energy use.

- The pulp & paper sector is a significant user of energy, particularly in mechanical pulping processes; it also faces strong competition from imported product from countries such as China, Brazil, Indonesia and Korea. The sector has a long history of producing renewable energy from 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 2004-05 with more than 12 000 TJ produced from renewable sources on-site.
- The solid wood sector is an energy user and a producer of renewable energy from residues. This renewable energy is used primarily in the form of heat but there are opportunities for the production of electricity from sawmilling residues.
- The plantation growing sector manages a significant fibre resource. Plantation expansion is contributing to Australia's performance against our Kyoto target; there is potential for increased production of renewable energy from existing plantation resources and residues, and for the development of purpose-grown crops for energy production.

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.

High rates of renewable energy generation and use

Many parts of our industry, particularly the pulp & paper sector, have historically high rates of renewable energy generation and use which are proportionally higher than the long term target of the RET Scheme. Despite this, they are exposed to increases in energy costs as part of the Government's objective of improving the overall average.

While creating market signals for investment in *new* renewable energy generation is an appropriate target for the scheme, it is important that the cost of implementing that target is not borne by industries and firms that already exceed the required national average and whose ongoing viability (and investment in further generation of renewable energy) is threatened by the costs of the scheme.

The RET Scheme should not disadvantage industries and firms with high current rates of renewable energy generation and use; on the contrary their contribution to the renewable energy mix should be recognised in the Scheme.