

# CLIMATE POLICY UPDATE

AUSTRALIAN INDUSTRY GROUP

JULY 2011

The Government's carbon package, the Clean Energy Future (CEF) plan, is a complex reform with major and sustained implications for our economy. In key design elements it is similar to the former Carbon Pollution Reduction Scheme. Ai Group members will view this package from many different perspectives. However, overall we are concerned about a number of aspects of the CEF, including: the unnecessarily high start price of \$23 a tonne; insufficient upfront support for less emissions intensive businesses; and the lack of a path to removal of expensive existing climate programs.

Ai Group will have further discussions with our members in the coming weeks ahead of the package going through Parliament. Views on how members will be affected will help inform our discussions with all sides in this important debate.

In the following pages we look at the design of the CEF plan and the competitiveness implications for trade exposed industries which is a central concern in the carbon pricing debate. We will also look at the impacts on households and assess how the plan measures up against Ai Group climate policy principles. The CEF plan has the following core features:

## Who's liable and for what?

- Liabilities would be imposed on the direct emissions of around 500 businesses from 1 July 2012, down from around 1000 under the CPRS due to the removal of fuel and synthetic gases from the system;
- Liabilities would be on emissions of carbon dioxide, methane, nitrous oxide and perfluorocarbons from facilities that emit more than 25,000 tonnes (CO<sub>2</sub> equivalent) of emissions in the relevant year (excluding liquid fuel emissions). Such businesses are already participating in National Greenhouse and Energy Reporting, and include major electricity generators and some industrial plants and mines.

## How much?

- Over the "fixed price period" for the three years from 2012-13, the price per tonne of emissions would rise at 2.5% above inflation, from \$23, to \$24.15 in 2013-14 and to \$25.40 in 2014-15.

## Tax moves to trading

- On 1 July 2015 the scheme would automatically convert to an emissions trading scheme with the price set in the market (price floors and ceilings will limit price volatility for the first three years of the emissions trading period);
- Once emissions trading starts, businesses could meet up to half their liabilities with valid imported permits (which reflect abatement that has occurred in other countries). This is a critical feature and would ensure that the domestic price is no greater than the international price of tradeable permits.

## When do we pay?

- In the fixed price period, 75% of businesses' estimated liabilities for each financial year would be due on 15 June of that year, with the balance due on 1 February the following year (facilities with less than 35,000 tonnes of emissions, or no historical data, would not have to make the earlier payment); liabilities incurred after the start of emissions trading would be due on 1 February of the year following the financial year in which liabilities accrue;
- Costs outside the carbon price would also be imposed through a separate mechanism on synthetic greenhouse gases and a variety of transport fuels (though not for passenger and light commercial vehicles or fuels used in agriculture, forestry or fisheries). See further details below.

## What help is available?

- The most highly exposed industries will be allocated a high proportion of their required permits at no cost. There is a further \$1.2 billion package for manufacturing, including grants for energy efficient capital investment. See page 2 for more details.
- Ai Group will work with the Government to develop the best design for these programs, and offer services to members to help them benefit from them.

# CLIMATE POLICY UPDATE

## TRADE-EXPOSED INDUSTRIES

The CEF carbon price would require around 500 large emitting businesses to purchase permits for their direct emissions of greenhouse gases. Other businesses would be affected indirectly, primarily through increases in the price of electricity and to a lesser extent gas. Treasury modelling suggests an increase in wholesale electricity prices of about \$18 per megawatt hour in the first five years of the scheme, though the precise passthrough remains to be seen. Delivered electricity prices for business are rising anyway, but currently range from \$100 to \$180 per megawatt hour, depending on size, location, date of contract and so on.

### Some impacted businesses can't pass on their costs

Impacted businesses can pass on their costs to the extent that their competitors are in the same boat. So dry cleaners, restaurants, truckers, domestic airlines and other businesses not exposed to international trade will raise their prices, though less efficient operators will be at a disadvantage. However, many of the affected businesses compete against imports or in global export markets and have limited or no ability to pass through cost increases. This competitiveness hit has been the central focus of Ai Group's representations to all sides of politics.

The CEF package includes several measures aimed at assisting trade-exposed industry. These measures have been a key focus of Ai Group's efforts in our discussions with the Government, the bureaucracy, members of the Multi-Party Committee on Climate Change and the Opposition during the period leading up to the announcement.

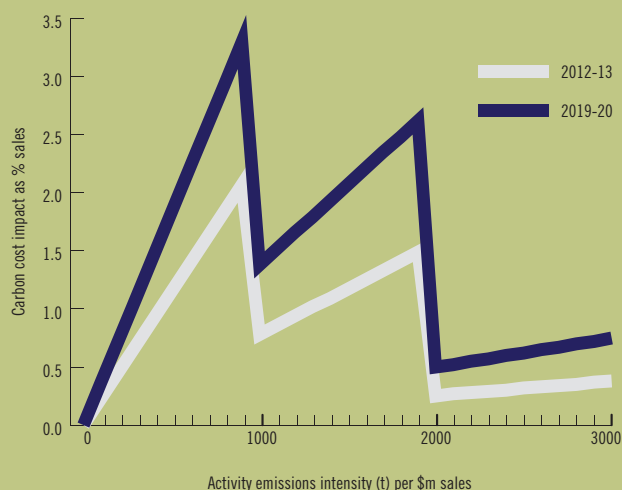
1. The **Jobs and Competitiveness Program (JCP)** – very similar to the previously proposed Emissions Intensive Trade Exposed program, this would issue free permits to the most exposed industries on an industry average basis that fully preserves incentives for individual businesses to reduce emissions.

Highly emissions-intensive activities such as aluminium smelting, steel and many pulp and paper activities would initially attract 94.5% assistance. Moderately intensive activities like glass container production would attract 66% assistance. This assistance would slowly decline over time. Regular reviews by the Productivity Commission would consider whether this reduction should halt (if competitors still did not face comparable carbon constraints), or whether the assistance should be extended or delivered differently. The JCP reduces liabilities for covered industries, though some moderate emitters still miss out.

2. The **Steel Transformation Plan** is aimed at the special issues affecting steel, involving \$300 million in additional assistance, and a modified JCP treatment that will increase effective steel assistance. This measure recognises the particularly intense pressures buffeting the steel sector.
3. The **Clean Technology Program (CTP)** would specifically assist manufacturing businesses, with grants for: capital investment in energy efficiency and emissions reduction (\$800m); industry low-carbon R&D (\$200m); and efficiency in the food processing (\$150m) and foundry (\$50m) sectors. These grants will require co-investment, mostly at 3 private dollars to 1 public dollar. There will also be an industry skills program (\$32m) and rollout of efficiency information to small business (\$40m). Capital grants should help make efficiency investments much more feasible, allowing benefitting companies to reduce their exposure. Accessibility and low transaction costs are key to making grants workable for businesses.
4. The **small business instant asset write-off** for businesses with a turnover of less than \$2 million per year will be increased from \$5,000 to \$6,500, providing a more attractive tax deduction for new assets – including more energy efficient ones. This will be of general benefit to small businesses, but its use in reducing exposure depends on increasing business knowledge of efficiency options.
5. The **Clean Energy Finance Corporation (CEFC)** will be established to invest in businesses seeking to commercialise and deploy renewable energy, energy efficiency and low pollution technologies. It will invest up to \$2 billion per year from 2013. Much detail remains to be developed, but this investment will be of great interest to companies looking to take up opportunities to make and roll out new and more efficient products.

The assistance package is focussed on manufacturers and is an improvement on the CPRS. However, businesses not receiving free permits will face the full impact of higher electricity and gas prices in the meantime and there is no program to offset these impacts. Free permit allocation will greatly assist the most exposed businesses, while the Clean Technology Program and Clean Energy Finance Corporation can, if effectively implemented, help manufacturers reduce exposure and seize opportunities over time.

### Industry impacts vary by emissions intensity



This Chart shows how different industries may be affected by the CEF carbon price. Without assistance, more emissions intensive activities would face a greater hit as a share of revenue. However, the JCP free permit allocation substantially lowers impacts for industries above 1000 or 2000 tonnes emissions per \$m revenue. For those somewhat below the 1000 tonne threshold, like some foundries, food processors, plastics and chemical manufacturers, paper and packaging manufacturers and metal product and fabricating companies, net impacts can be higher than for more assisted industries. Somewhat less intensive industries can benefit from the \$1.2 billion CTP package, but most will not receive upfront assistance with the immediate cost impact.

Most manufacturing and all service companies will be well below a 300 tonne intensity. The Chart only includes JCP permit assistance, and not any potential benefit from the other programs listed above. It assumes a 0.5% annual energy efficiency improvement – opportunities may be higher or lower for individual businesses and activities.

# TRANSPORT FUELS AND SYNTHETIC GREENHOUSE GASES

Transport fuels would be treated in a variety of ways.

Fuel used in light vehicles (of 4.5 tonnes gross vehicle mass or less) would not attract liabilities. Off-road use of these fuels in the agriculture, forestry and fishery industries would not attract liabilities. Bio-fuels would not attract liabilities and nor would transport fuels when used as solvents or lubricants.

Liabilities would apply in the form of excise adjustments and changes in fuel tax credit arrangements from 1 July 2012 for: domestic aviation; domestic shipping; rail transport; off-road transport of liquid and gaseous fuels; and non-transport use of these fuels (eg use of diesel in back-up generators).

The Government proposes to impose liabilities from 1 July 2014 on road transport use of fuels in heavy vehicles (more than 4.5 gross vehicle mass) by reducing fuel tax credits. This measure was not agreed by the full Multi-Party Committee and it is not yet clear if this aspect will pass the Parliament.

Synthetic greenhouse gases (apart from perfluorocarbons) would be subject to an effective carbon price imposed through a rise in existing import and manufacture levies under the Ozone Protection and Synthetic Greenhouse Gas Management legislation.

Affected users of diesel would initially pay about 6 cents more per litre.

## MEASURES FOR HOUSEHOLDS

The Government plans to at least offset the extra costs borne by low- and middle-income households through a combination of income tax cuts and changes to pensions, allowances and family payments.

It estimates that 90% of households would receive some benefit from these changes and that 66% of households would receive a benefit that is at least sufficient to offset their increased costs.

The Government claims that around 4 million households are set to receive assistance worth at least 120% of their expected liabilities.

### Income tax changes

The income tax proposals involve raising the tax-free threshold from its current level of \$6,000 to \$18,200 in 2012-13 and further to \$19,400 in 2015-16 when the emissions trading regime is scheduled to start.

To limit the extent to which the increase in the tax-free threshold would flow through to higher income earners and to reduce the cost of the income tax changes, the Government proposes reducing the Low Income Tax Offset and raising the rates of tax in the bottom two income tax brackets. Individuals earning more than \$80,000 would get barely any benefit from the income tax changes.

CURRENT SCALE			FROM 1 JULY 2012-13			FROM 1 JULY 2015-16		
from	to	rate	from	to	rate	from	to	rate
0	6,000	0	0	18,200	0	0	19,401	0
6,001	37,000	15%	18,201	37,000	19%	19,401	37,000	19%
37,001	80,000	30%	37,001	80,000	32.5%	37,001	80,000	33%
80,001	180,000	37%	80,001	180,000	37%	80,001	180,000	37%
180,001	and over	45%	180,001	and over	45%	180,001	and over	45%
The low income tax offset (LITO) of \$1,500 also applies, raising the effective tax-free threshold to \$16,000			The LITO is scheduled to reduce to \$445 and the effective tax-free threshold would be \$20,452			The LITO is scheduled to reduce to \$300 and the effective tax-free threshold would be \$20,979		

### Main non-tax changes

All Commonwealth Senior Card holders (including self-funded retirees) would receive an upfront payment of \$250 for singles and \$190 per person in a couple before the end of the 2011-12 financial year. An ongoing supplement equal to a 1.7% increase in the maximum rate of the pension would be paid quarterly from March 2013.

Age pensioners, other pensioners and recipients of allowances would also receive an up-front payment before the end of the 2011-12 financial year and a similar ongoing supplement paid fortnightly from March 2013.

Families eligible for the Family Tax Benefit would receive an upfront payment before the end of the 2011-12 financial year and ongoing supplement paid quarterly from March 2013.

## How does the Clean Energy Future plan stack up against Ai Group's principles?

Ai GROUP PRINCIPLE	Ernst & Young assessment of February framework	Ai Group assessment of completed CEF package
<b>The competitiveness of Australian industry cannot be eroded</b>	Given risk of being ahead of relevant competitors, Government should provide measures for trade-exposed industry, including higher assistance to a broader set of industries in the short term than previously proposed.	Assistance is substantial, but does not address the immediate impacts on more moderate emitters. Free allocation imposes unnecessarily high initial burdens (see chart page 2). Free permit allocation has been improved in several respects, but not extended to more sectors. The start price is unnecessarily high.
<b>Australia should be able to meet its international emissions reduction commitments at least cost</b>	Appropriately designed, a carbon pricing scheme can drive the cheapest abatement options across the economy, and avoid many of the administrative burdens and inefficiencies found with more interventionist government policies.	The final design is efficient and could drive the emissions reductions sought at close to the lowest whole-of-economy cost. However, the co-existence of a range of other measures undermines the full benefits that could flow.
<b>Climate policy must respect existing investments to avoid acute short-medium term disruptions while supporting efficient long-term investment in the energy and other sectors</b>	Ambiguities and gaps meant the framework risked failing to effectively reduce the current severe investment uncertainty in electricity generation. A package would be needed for the most impacted existing generators.	A mix of cash, permits, and potential loans and shutdown payments is available to existing generators. Measures for existing investors in electricity generation, appear substantial but implementation will determine effectiveness.
<b>Policy must support R&amp;D of new approaches to reducing emissions while refining existing approaches</b>	While carbon pricing would spur innovation across the economy, the Government needed to enhance its additional low-carbon R&D support to ensure it is substantial, targeted and effective.	The \$10b for Clean Energy Finance, and consolidation of existing energy R&D funding into ARENA, are major steps to a larger and more effective effort on research, development and deployment.
<b>Compliance costs and regulatory burdens should be minimised</b>	The existing tangle of climate programs and regulations does not promote the lowest cost options for cutting emissions. The Government's lack of clear process to cutting back these measures risks imposing additional costs and undermining an otherwise efficient policy.	Disappointingly, there has been no announcement on the pruning of existing measures. In its principles, the CEF itself seems well designed to minimise compliance costs and burdens, with even fewer companies directly involved than anticipated.

# Ai GROUP MEDIA RELEASE

## CLIMATE PACKAGE: INDUSTRY REMAINS CONCERNED ABOUT DAMAGE TO COMPETITIVENESS

“Today’s package is complex and raises many questions which we will need to examine closely in consultation with our members. At first glance, however, our evaluation suggests that large parts of industry will be underwhelmed and will remain deeply concerned that their competitiveness will be damaged. This is especially so in these very uncertain economic times when manufacturing in particular is experiencing extremely stressful economic conditions,” Australian Industry Group Chief Executive Heather Ridout said today.

“While the Government has gone some way to addressing industry issues, the climate change package announced today falls short in a number of critical areas:

- The measures providing transitional support to trade exposed businesses need to be strengthened;
- The initial price of \$23 is excessive and should be reduced;
- There is no plan for cleaning out the existing array of inefficient and costly greenhouse gas abatement measures.

“Today’s announcement leaves many exporting and import-competing businesses exposed to a sharp erosion of competitiveness. For some businesses these extra costs could equate to almost 2.5 per cent of revenue and imply a significant reduction in their margins.

“Further, the design of the support programs for manufacturing has an emphasis on grants for investment in innovation and leaves businesses exposed to extra costs in the meantime. Moreover, the design of the grants program itself raises issues including accessibility and flexibility to meet the varied needs of business and the Government needs to consult closely with business on this.

“The initial price of \$23 a tonne, which the Greens took to the last election, will present a major shock to industry and there is a significant risk that in 2012-13, the carbon price in Australia will be above global prices.

“The \$23 price is particularly hard to accept when it is added to the impact of the numerous existing, mostly wasteful, carbon reduction measures imposed by federal and state governments. The fact that the package does not do anything to clean out these measures leaves industry with a much greater effective price on carbon.

“The Government has quite rightly sought to provide the greater degree of certainty required to support investment, particularly in energy generation, and this will be welcomed by those supplying into this industry.

“Ai Group’s engagement and the spotlight we have put on small business and the manufacturing sector is reflected in the increased write-off provisions for small business, the comprehensive steel program and the clear focus on manufacturing in the Clean Technology Investment Program; the Clean Technology Innovation Program; the programs for the food and foundry sectors; and the Clean Energy Finance Corporation. While this assistance is welcome, the design of the measures needs to be improved.

“Ai Group will continue to seek improvements to this package, and consult closely with our member companies in the coming months as the package moves through the Parliament and the review processes,” Mrs Ridout said.

10 July 2011