



Submission on
Abatement Incentives Prior to the Commencement of the Australian
Emissions Trading Scheme

November 2007

The Australian Industry Group

The Australian Industry Group (Ai Group) is Australia's leading industry organisation representing 10,000 employers across a broad and expanding range of sectors, including manufacturing, construction, automotive, telecommunications, food & beverages, ICT & call centres, defence, transport and labour hire.

Our members operate businesses of all sizes throughout Australia and employ almost half a million people. We provide practical information, advice and assistance to help members run their businesses more effectively and to become more competitive on a domestic and international level.

We also ensure our members have a voice in all levels of government, by representing and promoting their interests on current and emerging issues.

Executive Summary

Ai Group appreciates the opportunity to comment on the *Abatement Incentives Prior to the Commencement of the Australian Emissions Trading Scheme Discussion Paper* (the Discussion Paper) and to engage in the ongoing process of consultation on the design of the Australian Emissions Trading Scheme.

Ai Group supports the objective of ensuring there are incentives for abatement in the period leading up to the commencement of the scheme.

Ai Group members have raised a number of specific concerns and/or matters for clarification with respect to the following:

1. Ensuring the allocation rules governing allowances of free permits under the ETS do not disadvantage businesses that undertake abatement before the commencement of the ETS
 - a. The 3 June 2007 date for determining eligible assets does not appear to be appropriate in relation to compensation arrangements for businesses in Trade Exposed Emissions Intensive industries.
 - b. The proposed definition of assets that are “in existence” appears unduly stringent.
2. Incentives to Undertake Additional Abatement
 - a. Investments in assets eligible for incentives under pre-existing arrangements.
 - b. Additional injections of capital into projects in existence prior to 3 June 2007.
 - c. When the ETS has commenced, how will abatement incentives be provided to businesses that are not liable but are not in “uncovered sectors”?
3. International offsets
 - a. With the new Government proposing to ratify the Kyoto Protocol, Ai group urges a high priority be attached to clarifying the status of international offsets.

Ai Group Submission

1. Ensuring the allocation rules governing allowances of free permits under the ETS do not disadvantage businesses that undertake abatement before the commencement of the ETS

- a. The 3 June 2007 date for determining eligible assets does not appear to be appropriate in relation to compensation arrangements Trade Exposed Emissions Intensive (TEEI) businesses.*

The Discussion Paper's approach to avoiding a loss of compensation due to abatement activity after 3 June 2007 is based on a statement (page 6) that "only assets in existence as at 3 June 2007 would be eligible for consideration under the Government's proposed compensation arrangements."

This claim may be supportable in relation to assets that experience a disproportionate loss of value. However, this claim is at odds with other statements about the intended approach to compensation in relation to trade-exposed emissions intensive industries.

For example, in *Australia's Climate Change Policy our economy, our environment, our future*, July 2007, the following statement was made:

"[T]he Government will ensure that the competitiveness of Australia's vital trade-exposed emissions-intensive industries is not reduced through direct and indirect carbon cost exposures. The Government notes the Task Group's recommendations, and will examine this issue in detail during the design phase.

Concessions will be provided only while key competitors do not face comparable carbon related costs and will be assessed on a five yearly basis. It will also be provided on the condition that those businesses continue to produce in Australia.

The Task Group's recommendations included the following¹ (emphasis added):

"The Task Group believes a suitable approach could be one that:

- allocated free permits to *existing investments* in trade-exposed, emissions-intensive industries equivalent to the carbon costs flowing from their direct (industrial process) and indirect (energy and embodied production inputs) post-tax costs. Over time, allocations to offset direct emissions could be based as if firms were using world's best practice low emissions technologies. ...
- allocated free permits to *any new investments* in trade-exposed, emissions-intensive industries to offset direct emissions 'as if' the investments were

¹ Report of the Task Group on Emissions Trading, Appendix L.

using world's best practice low-emissions technology, and provided free permits equivalent to the post-tax costs of their actual indirect emissions.”

If compensation arrangements for TEEI businesses are to apply both to existing investments and to any new investments, arrangements related to avoiding disadvantage for early abatement should also apply both to existing and new investments.

b. The proposed definition of assets that are “in existence” appears unduly stringent

The criteria proposed for defining assets that are “in existence” appear unduly restrictive. For instance they include the requirements that:

- The project proponent has obtained all required planning and construction approvals and licences, including completed and approved environmental impact statements (these include planning and environmental approvals from duly authorised planning bodies at both State and Federal Government levels); and,
- Financing arrangements for the proposal, including debt plans, have been finalised and contracts executed.

A less restrictive approach could involve less strict rules including scope to appeal for further consideration in borderline cases. Alternatively, the date of effect could be set in September 2007 when the Discussion Paper proposing these rules was released.

2. Incentives to Undertake Additional Abatement

The rationale for limiting eligibility to projects that commenced after 3 June 2007 is that projects embarked on before that date were undertaken before the intention to create an Australian ETS was announced. Investors in projects embarked upon before this date were prepared to risk that an ETS would not be introduced in Australia or that their investments would not be eligible for credits. Providing early action credits or offsets in these cases is seen as unnecessary.

a. Investments in assets eligible for incentives under pre-existing arrangements.

This rationale is not as convincing for projects which were eligible for credits or offsets under regulatory arrangements in existence before 3 June 2007 and which may be removed or adversely affected as a result of the Australian ETS. While the Discussion Paper (pp.13-14) appears to indicate an awareness of this issue specifically in relation to the Greenhouse Gas Abatement Scheme and foreshadows separate consultation, further clarification would be welcomed.

b. Additional injections of capital into projects in existence prior to 3 June 2007.

The treatment of additional capital injections into projects that were in existence prior to 3 June also needs to be considered closely. The allocations of additional capital between an existing project and a new project should be made on the merits of the investment (i.e. on the relative efficiency of abatement) and not on the basis of whether the project was or was not in existence prior to 3 July 2007.

c. When the ETS has commenced, how will abatement incentives be provided to businesses that are not liable but are not in “uncovered sectors”?

The Discussion Paper distinguishes between “covered” and “uncovered” sectors. One of the reasons for doing so is that (page 9):

“only sectors outside the scheme (that is, those without a liability to acquire permits under the scheme) will be able to create offsets after 2011.”

This approach appears to confuse two concepts: businesses that do not have a liability and businesses in uncovered sectors. As Ai Group understands it, the proposed Australian ETS is based on extending liability to acquire permits to all facilities with direct emissions above a certain threshold unless those facilities are in sectors that are nominated as “uncovered”. There would therefore be two classes of direct emitters not be liable to acquire permits: those in the nominated uncovered sectors and those below the threshold.

The Discussion Paper puts forward a strong argument for ensuring that businesses in uncovered sectors should have incentives to reduce direct emissions. In Ai Group’s view the same argument applies to directly-emitting facilities that are not in the nominated uncovered sectors and which do not have a liability to acquire permits because their level of emissions is below the threshold.

If the post-commencement approach taken in the Discussion Paper is followed it is likely to be associated with less than optimal environmental outcomes and it may introduce perverse incentives into the market.

Further, the Discussion Paper appears to be proposing an approach under which owners of below-threshold emitting facilities in covered sectors would have an incentive for abatement prior to the commencement of the ETS but would have no incentive after the commencement of the ETS.

3. International offsets

- a. With the new Government proposing to ratify the Kyoto Protocol, Ai group urges a high priority be attached to clarifying the status of international offsets.*

With Australia ready to ratify the Kyoto Protocol, the opportunity will soon exist for Australian companies to participate in CDM projects and earn international offset credits. The Australian emissions trading scheme should recognise international offsets to encourage Australian companies to invest in CDM projects in developing countries (including AP6 partners).