



AUSTRALIAN INDUSTRY
GROUP

Submission to the Prime Minister's Task Group on Emissions Trading

Ai Group

March 2007

Table of Contents

Overview	2
Ai Group’s Policy Principles	4
Context Setting	5
A Workable Global Emissions Trading Scheme	9
Domestic Action to Prepare for a Workable Global Scheme	12
Other Measures	13
Appendix 1 Ai Group’s Snap Survey	18

Overview

Ai Group is one of the largest national industry bodies in Australia, representing businesses in manufacturing, construction, automotive, defence, graphic arts, information technology, telecommunications, call centres, labour hire, airlines, transport and other industries.

Ai Group recognises the evidence of association between the accumulation in the atmosphere of greenhouse gases and global warming. Ai Group also recognises that significant global warming is likely to have detrimental environmental and economic impacts and that there is a strong case for effective action to mitigate the emission of greenhouse gases. To be environmentally effective, measures must impact on global emissions and not simply shift the locations from which greenhouse gases are emitted.

Ai Group is firmly of the view that the competitiveness of Australian business should be at the centre of considerations about the adoption of further regulatory measures to constrain greenhouse gas emissions.

The objectives of environmental effectiveness and giving a central consideration to Australian competitiveness lead to the same conclusion: any steps taken in Australia to constrain greenhouse gas emissions should be linked to clear progress towards effective global measures.

Ai Group does not underestimate the task at hand. Even if greenhouse gas abatement policies were adopted uniformly around the globe, Australia would face a relatively heavy adjustment task due to our present economic pattern. This pattern is associated with:

- our high level of per capita emissions;
- the relatively emissions-intensive nature of a number of our leading exports;
- the high emissions associated with the use in other countries of other leading exports; and,
- the fact that the advantages of many of our import competing industries rests in part on the availability of relatively cheap energy and other natural advantages that could be significantly eroded in a carbon constrained world.

In the absence of a global approach, the risks to Australian competitiveness and the extent of adjustment imposed would be even greater.

While Ai Group believes that Australia should be proactive in the development of effective global responses to the mitigation of greenhouse gas emissions, we also maintain that Australia should not pursue a course of action that sacrifices domestic competitiveness before effective global measures are firmly in prospect.

Ai Group supports the adoption of an effective global response to the mitigation of greenhouse gas emissions.

- We strongly support a market-based approach - such as emissions trading – in preference to direct regulation.
 - The greatest benefits from a market based approach would be achieved with a broad coverage with as few regional or sectoral sub-targets as possible.
 - To avoid disincentives against adopting emission-reducing measures, the design of any emissions trading scheme should recognise early action taken to reduce emissions.
 - To the fullest extent possible existing regulatory arrangements on greenhouse gas emissions should be removed or folded into any new arrangements to improve efficiency and reduce compliance burdens.
- Such an approach should be phased in over timeframes that permit reasonable time for adjustment.
- Australian measures should be consistent across the country and should have the support of all levels of government.
- Net additions to government revenues generated by policies to reduce the growth of greenhouse gases should be applied to reducing existing taxes - particularly those borne by business.
- In designing any additional measures to reduce greenhouse gas emissions, strong preference should be given to a market-based approach such as emissions trading.

In advance of such an approach being developed there are many important steps that can be taken by governments, business and households to reduce emissions and improve energy efficiency. Ai Group believes Australian governments should take a leading role in informing and encouraging the development and adoption of emissions reduction and energy saving measures.

In the remainder of the submission we firstly set out the policy principles we have developed on climate change and greenhouse gas abatement policies and we address a range of issues under sub-headings that correspond to those in the Issues Paper.

To assist in preparing this submission Ai Group conducted a Snap Survey as part of our consultation process. We include the results of our Snap Survey in a number of places in our submission. As made clear in the discussion about the Snap Survey in Appendix 1, these results should be regarded as indicative and pointers to more rigorous research.

Ai Group's Policy Principles

Ai Group positions in this area remain the subject of ongoing work. In our discussions to date we have developed the following principles. These are subject to further refinement as we undertake additional research and consultation with our members.

1. Australia should be proactive in the development of effective, global responses to climate change that constrain the growth of greenhouse gas emissions.
2. The competitiveness of Australian business should be a leading consideration in the development of any policy options.
3. Any policy options developed should aim to maximise certainty for medium and longer-term investments.
4. Any additional policy measures adopted by Australia should be linked with clear progress towards effective global measures.
5. Any additional measures adopted by Australia should be phased in over timeframes that permit reasonable time for adjustment.
6. Any additional measures adopted by Australia should be consistent across the country and should have the support of all levels of government.
7. Net additions to government revenues generated by policies to reduce the growth of greenhouse gases should be applied to reducing existing taxes - particularly those borne by business.
8. In designing any additional measures to reduce greenhouse gas emissions, strong preference should be given to a market-based approach such as emissions trading.
 - a) The greatest benefits from a market based approach would be achieved with a broad coverage with as few regional or sectoral sub-targets as possible.
 - b) To avoid disincentives against adopting emission-reducing measures, the design of any emissions trading scheme should recognise early action taken to reduce emissions.
 - c) To the fullest extent possible existing regulatory arrangements on greenhouse gas emissions should be removed or folded into any new arrangements to improve efficiency and reduce compliance burdens.
9. A key avenue for policy should be on informing business and the broader community of options for energy efficiency and emissions reduction and in providing incentives for their research, development and adoption.

Context Setting

A Group agrees with the three criteria put forward in the Issues Paper as important to developing an effective approach to addressing climate change. These criteria are that any policy solution should:

- result in acceptable global environmental outcomes;
- be achieved at the lowest possible cost and keeping distortionary impacts to a minimum; and
- be capable of attracting sufficient support internationally, including the participation of developing nations.

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

There appears to be a high likelihood of adverse environmental and economic impacts unless there is effective global action to mitigate net emissions of greenhouse gases.

From this perspective, Australia is likely to be better off both environmentally and economically if these adverse impacts could be avoided. If effective action to mitigate the accumulation of greenhouse gases assisted in avoiding these sorts of impacts, Australia's domestic economic activity and our opportunities to participate in global economic activity are likely to be stronger than if effective mitigating measures were not adopted.

Putting aside this broader perspective, measures to mitigate greenhouse gas emissions are likely to imply that a number of areas of activity, including a number in which Australia has strong participation – for example coal, metals, chemicals and livestock production, could experience cost increases, price increases and reductions in *global* demand relative to levels that would have otherwise prevailed.

Conversely, other areas of activity would experience an increase in demand and opportunities as relative prices shifted in their favour. These include energy sources with relatively low greenhouse gas intensity as well as activities that generated carbon credits. Australia is well positioned to take advantage of many of these opportunities – for example in, renewable energy; nuclear energy and through the large land area that could be available for offset activities.

On balance however, it is likely that Australia would bear a relatively high cost of adjustment in the face of measures to reduce greenhouse gas emissions.

- Australia has a comparatively high level of per capita emissions and would confront a commensurately high burden if additional costs were imposed on emissions.

Even putting to one side the very important impacts on export and import-competing industries, there would be distinct adjustments arising from the additional costs and change in relative prices within the domestic economy.

- Australia's exports are relatively emissions-intensive.
 - About 25% of total Australian emissions have been attributed to exports¹ compared with a ratio of exports to GDP of around 20 percent.
 - In addition, in their use many of Australia's exports are associated with high emissions. Their demand is likely to be adversely affected by policies to mitigate greenhouse gas emissions.

With this export profile, *even if greenhouse gas abatement policies were adopted uniformly around the globe*, Australia's competitive position would be relatively adversely affected.

- In some areas of activity the ability of domestic businesses to compete in the domestic market against imported goods rests on the availability of low-cost energy. Even if uniform global action were taken to mitigate greenhouse gas emissions, this source of competitive advantage may be eroded and Australia's competitive position adversely affected.

While, to some extent, the impacts on the competitiveness of our export and import competing sectors could be offset by a fall in the value of the Australian dollar, there would still be a comparatively significant adjustment process both in the domestic economy and within the traded sectors.

If Australia participated in an approach that was not clearly linked to progress towards an effective globally response, the extent of adjustments and the economic costs borne by Australians would be correspondingly more severe.

To what extent is Australia currently factoring a carbon price into investment decisions?

While the extent to which a carbon price is being factored into investment decisions is not possible to quantify, there can be little doubt that for some investments at least uncertainty over the regulatory environment is impacting on decision-making.

One illustration of this is provided by the agreement reached between the New South Wales Government and BlueScope Steel in November 2006 in relation to investments the company is considering for a power plant producing electricity using by-product gases from steelmaking. These gases would otherwise be flared. Among other things the agreement provided BlueScope Steel with assurances about the application of existing and prospective regulatory arrangements impacting on greenhouse gas emissions.

¹ Australian Bureau of Statistics, Year Book Australia, 2003.

At the time the agreement was announced BlueScope Steel Chief Executive Officer Kirby Adams said: “In making this agreement, the NSW Government has eliminated a major barrier to these investments in the Port Kembla Steelworks, by providing certainty in relation to future NSW action on the regulation of greenhouse gas emissions.”²

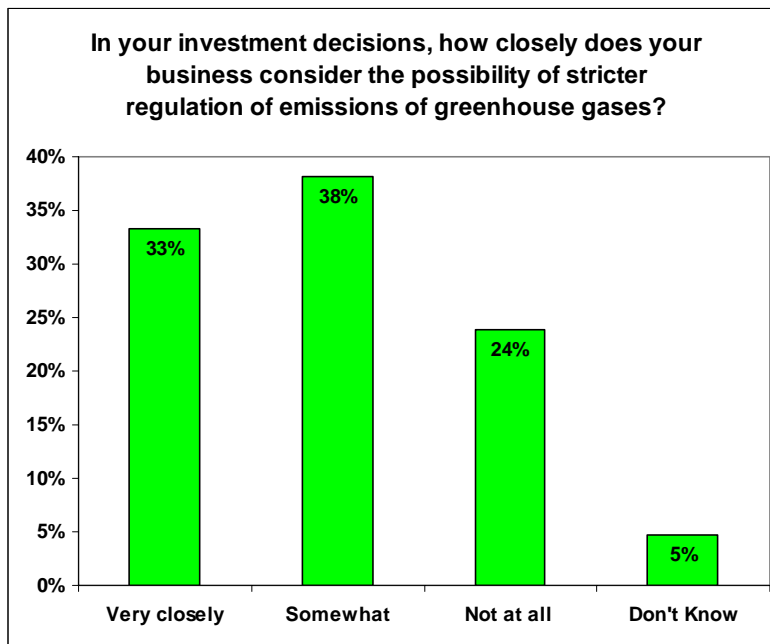
Additional evidence is available in the behaviour of electricity generators who give very close consideration to the possibility of changes in regulatory arrangements in their investment decisions. Investments in coal-fired generating equipment which might be expected to be relatively attractive under existing price and cost patterns are being passed over in favour of alternative investments in gas-fuelled processes.

More generally, businesses contemplating medium and longer-term investments in plant and processes are currently faced with a high degree of uncertainty over regulatory directions. Whatever the particular responses of individual businesses to this, it is very likely that in aggregate the current investment pattern is less than optimal. This applies both to investments which would imply a greater level of emissions and investments in abatement and offset activities.

Snap Survey Results

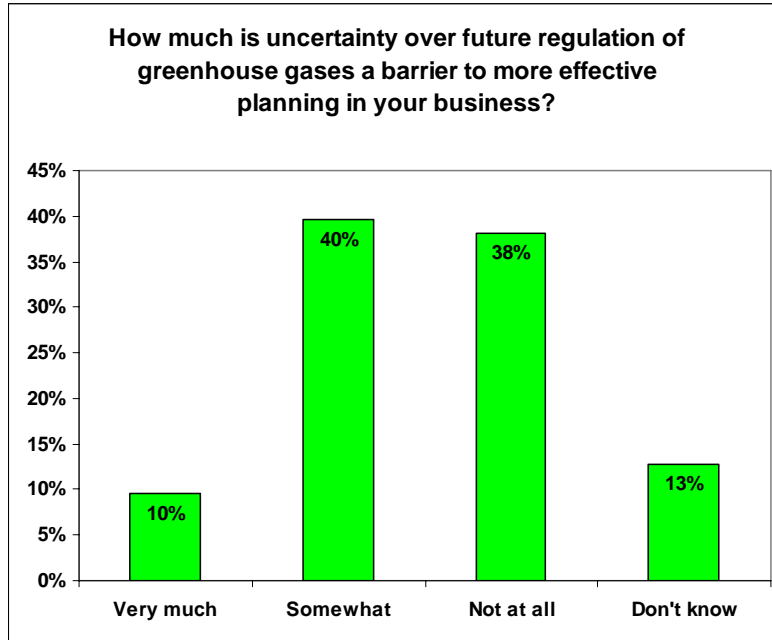
In our Snap Survey (see Appendix 1) we asked two questions relevant to the question of the impact of this source of regulatory uncertainty on investment decisions.

In response to the first of these, one third of respondents said that in their investment decisions the possibility of stricter regulation of greenhouse gas emissions was considered “very closely”. A further 38 percent indicated that this was “somewhat” of a consideration in their investment decisions.



² Bluescope Steel Media Release, 16 November 2006, *NSW Government and BlueScope Steel: Working together to reduce greenhouse emissions*.

The second question tested the degree to which uncertainty over future regulation acted as a barrier to business planning. Ten percent of respondents indicated “very much” and a further 40 percent indicated that such uncertainty was “somewhat” of a barrier to business planning.



A Workable Global Emissions Trading Scheme

When fully operational an ideal global emissions trading scheme would include (or link to other mechanisms that included) all countries and all greenhouse gases from all sources and which permitted credits for offsetting activities.

Ai Group recognises that, in the initial stages, arrangements that are less than ideal may serve as stepping stones in the transition to a more ideal arrangement.

- The approach of the European Community Emissions Trading Scheme (EC ETS) is for the progressive addition of participating countries, more extensive coverage of emissions, an expansion of the availability of credits and a tightening of emissions caps over time.
- Similarly, the National Emissions Trading Scheme (NETS) being developed by the States and Territories envisages a phased expansion of coverage and a phased reduction in permits for emissions.

In both of these cases, the design of the arrangement involves a directional statement of end position, a general pathway with timelines for the scheme's progressive expansion and specified arrangements established to firm up the arrangements over time.

These features would facilitate the objective of providing adequate time for adjustment and, while not providing complete certainty, would assist in business planning.

Protection of Competitiveness

The protection of Australia's competitiveness would best be achieved if all countries were included in a global approach. As noted above however, given our high per capita emissions and the nature of many of our advantages in international trade, the adjustment task facing Australia would be relatively onerous even if a global approach were adopted.

In the context of Australia participating in a workable global approach, key considerations that would assist in the protection of competitiveness would include:

- Timeframes that give adequate time for businesses to adjust.
- Design of Australian policy instruments that place the competitiveness of Australian business at the centre of considerations. In line with the principles set out above, this would involve:
 - consistency of approach across the country;
 - ensuring that net additions to government revenue are used to reduce other taxes and charges on business; and,
 - ensuring that policies apply as broadly across the economy as possible.
- In considering the protection of competitiveness in the design of policy instruments, the degree to which additional costs are passed on is clearly relevant.
 - Some producers, particularly in non-tradable sectors, are able to protect their own competitiveness by passing cost increases onto their customers.

- Whether resources should be applied to provide additional compensation in these cases is highly questionable and any resources used in this way would certainly detract from those available for the more central purpose of protecting competitiveness.
- Conversely, many businesses are likely to experience significant cost increases, for example in relation to their energy usage. Particularly when such businesses compete in export markets or against imports in the domestic market, their competitiveness will be adversely affected. Even if these businesses are not themselves direct emitters, the impacts of policy changes on their competitiveness needs to be included in the design of policy measures aimed at protecting competitiveness.

To the extent to which, during a period of transition to a workable global approach, Australia was involved but other countries were not, the protection of domestic competitiveness would assume even greater importance. Such protection is equally relevant for the export sector and import competing businesses.

One approach to the protection of competitiveness that has been discussed (for example in the context of the National Emissions Trading Scheme) involves the free allocation of emission permits to businesses and sectors that were adversely affected.

It is likely that this would be preferable to an approach that offered exemptions to some industries or particular businesses. Exempting companies outright does not create incentives for them to reduce emissions and is it likely the burden of adjustment would fall unnecessarily heavily on businesses and households that were not exempt.

An approach based on the allocation of permits could be complemented by a mixture of targeted subsidies or tax concessions.

Ai Group does not underestimate the difficulties involved in the design and appropriate targeting of such policies particularly in their application to import competing businesses. Ai Group urges very close consultation with business in any policy development in this area.

Advantages and Disadvantages of Australia's Early Participation

Some possible advantages of early participation include a greater assurance of a seat at the table in the evolution of the scheme; the earlier participation in the learning process; more gradual adaptation to the specific regulatory arrangements and earlier exposure to some opportunities.

On the negative side the major disadvantage is the risks that additional costs would be imposed on Australian businesses to the detriment of competitiveness and economic performance, investment and employment. .

Many of the possible advantages could be offset by close monitoring of developments; active participation in international forums and through contributions to international policy discussion. Many of the advantages relating to opportunities for Australian businesses could be obtained through a variety of means even if Australia as a nation is not itself an early participant.

While the balance between costs and benefits is something that requires ongoing monitoring, in Ai Group's view the weight of argument presently rests against early participation.

Domestic Action to Prepare for a Workable Global Scheme

Regardless of other policy initiatives taken in relation to climate change, a leading direction should be in providing incentives for research, development and adoption of emissions reduction and energy-saving measures. This should be complemented by efforts to provide greater information both to business and households about options for energy efficiency and other greenhouse gas abatement strategies.

Introduction of a domestic emissions trading scheme in advance of a global scheme

There could be some advantages from Australia's introduction of a domestic emissions trading scheme (ETS) in advance of a workable global scheme.

- The adoption of a domestic ETS could change prices, incentives and induce behavioural changes in the direction of reducing net Australian emissions.
- In particular, a domestic ETS could also facilitate the exploration and development of low-emission alternatives and activities for which carbon credits could be generated.
- To the extent the domestic scheme also provided greater certainty over the future cost of emissions, there could also be benefits in terms of providing a clearer outlook for long-term investment.
- There may be further benefits in terms of the development of a reporting framework and the build-up of experience and systems required to comply with new regulatory arrangements.

However the early introduction of a domestic ETS would also carry costs. At the aggregate level these are the costs of slower economic growth than would otherwise occur due to the imposition of extra costs of production and higher prices. This would have adverse impacts on real disposable incomes, employment and wages growth.

While the tradable sector may be able to be protected from the impacts of a domestic ETS, this would imply a greater of adjustment borne by domestic consumers and businesses producing for the domestic market.

In the absence of a more comprehensive global approach to reducing greenhouse gas emissions, the net environmental impacts of unilateral Australian measures could be expected to be neutral at best.

While this is also an area that requires ongoing assessment, on balance Ai Group cautions against the adoption of a domestic emissions trading scheme at this time.

Other Measures

Policies to improve general competitiveness

Discussion of the possible impacts of additional regulation of greenhouse gas emissions needs to be seen against the broader policy context. In particular, there is considerable scope across a wide range of areas to improve the underlying competitiveness of the Australian economy. The case for adopting these measures is already strong: it is strengthened even further in the light of the adverse impacts that are likely to flow from measures to abate greenhouse gas emissions.

These policies include:

- Expanding Australia's skill base and improving our education and training systems so they are more flexible and give greater weight to the retraining and upskilling of people after they have entered the workforce.
- Giving greater emphasis to the development of business capabilities.
- Continuing to remove barriers to flexibility in the design of work and workplace relations.
- Encouraging and removing barriers to workforce participation.
- Facilitating appropriate levels of investment in infrastructure (including in the areas of water, energy, telecommunications and transport) and improving the planning and coordination of infrastructure across the federation.
- Fostering and encouraging innovation and productivity improvements in businesses and in the public sector.
- Reducing the regulatory burden on business.
- Improving the design and workings of Australia's federal system.
- Continuing the process of improving the Australian taxation system.

Providing information and encouraging energy efficiency and emissions reduction

Ai Group maintains that governments have an important role to play in informing businesses and households about opportunities for energy reduction and emissions reduction.

Ai Group is currently developing proposals that would enlist Commonwealth Government assistance in providing such information to businesses.

Incentives

A domestic ETS would have some positive impact on incentives to conduct research and development into low emissions technologies and on the take-up of existing and new abatement measures. However, particularly in the absence of more comprehensive global approach, it is unlikely that the overall incentives will be sufficiently strong to make a marked difference. This is most clearly the case where Australia would be competing with countries that did not tighten regulation of greenhouse gas emissions.

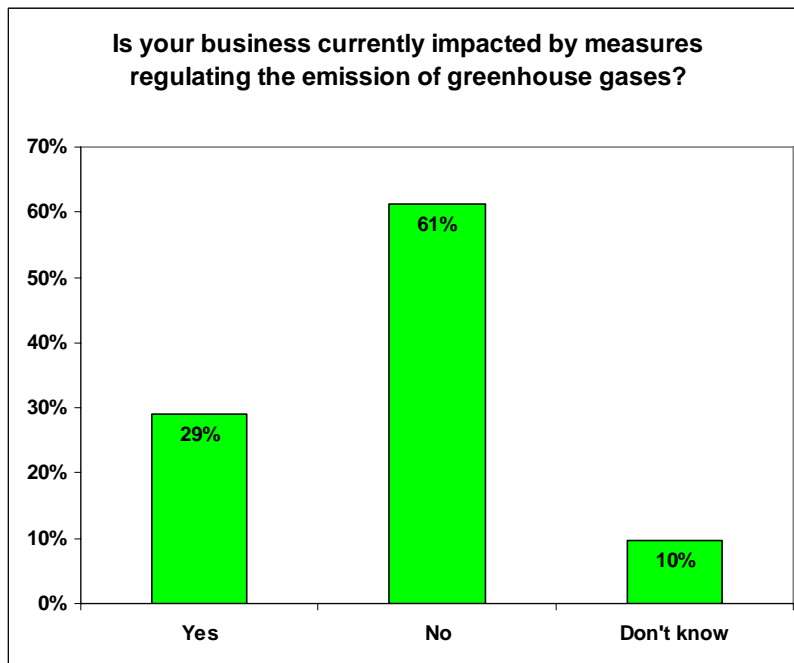
Even if a domestic ETS was introduced, Ai Group anticipates that additional measures such as tax incentives and direct grants would be desirable to further encourage these outcomes. These measures could be put in place in the absence of a domestic ETS with similar results.

Would there be scope to abolish existing regulatory arrangements?

Current regulatory instruments for achieving improved energy efficiency include the mandatory Commonwealth Energy Efficiency Opportunities program, elements of the fuel rebate scheme, state-based mandatory energy efficiency measures for high users, and the NSW emissions trading scheme.

Snap Survey Result

In our Snap Survey (see Appendix 1) we asked whether businesses were currently impacted by measures regulating greenhouse gas emissions. Almost 30 percent of respondents indicated that they were impacted.



If an effective emissions trading scheme were in place, many existing regulatory measures could be removed and the considerable time and resources invested in compliance, reporting and administration would no longer be necessary. One member in the chemicals and plastics sector for example who already deals with “a complex web of legislation” has expressed concern about the regulatory burden that may accompany the adoption of an emissions trading scheme. They have suggested that such a scheme should

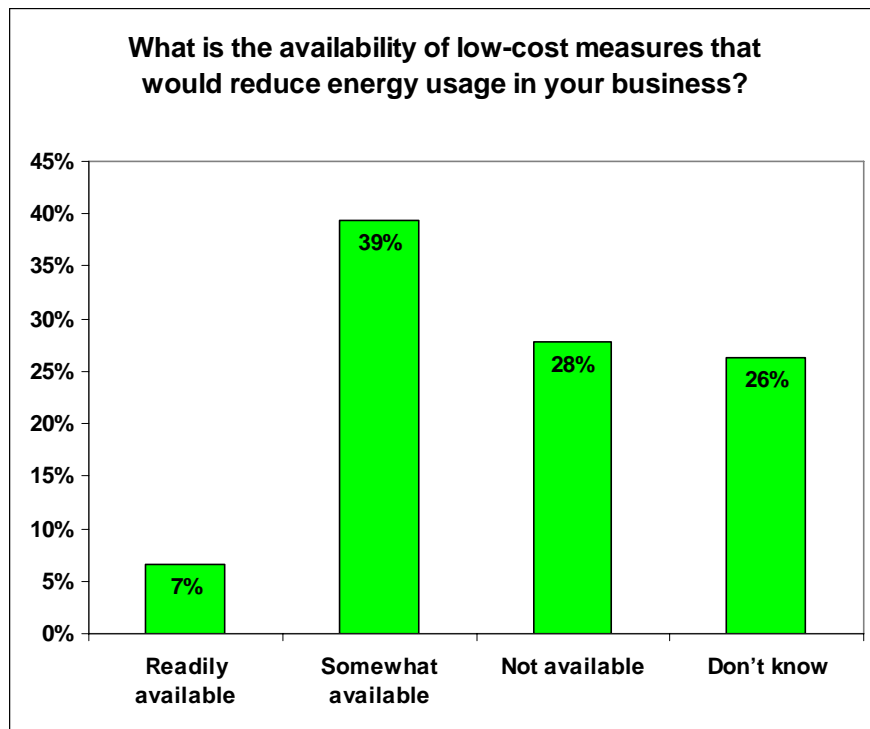
provide for the removal of the existing regulatory burden that will no longer be necessary when greenhouse gas abatement is driven by an emissions trading market.

Ai Group believes that maximum advantage should be taken of the potential for removing existing regulatory regimes and scaling back the burden imposed by these regimes.

What low-cost abatement activities are currently available?

Snap Survey Question

In our Snap Survey (see Appendix 1) we asked businesses about the availability of low-cost measures that would reduce energy usage. Only seven percent indicated that such measures were readily available while for a further 39 percent low-cost energy-saving measures were somewhat available.



Improving energy efficiency among consumers of energy is a leading avenue for abatement reduction. Ai Group provides a service to our members through the *Australian Industry Group Energy and Sustainable Business Help Desk*. The Help Desk provides members with technical advice across a range of areas related to resource efficiency and environmental management. In preparing this submission we asked the Help Desk for information about widely applicable energy-saving steps.

Advice from the Australian Industry Group's Energy and Sustainability Help Desk

While many areas of energy saving are specific to individual businesses, our Help Desk has identified the following six measures that have applied to a wide range of the companies who have accessed technical advice from the Help Desk. These six initiatives are proven energy savers that can often be implemented for little incremental cost. Even with prevailing price levels, these measures usually offer long-term savings with excellent payback periods.

Air Conditioners

Particularly as cooler weather approaches there are strong opportunities to minimise re-heat and maximise the use of free cooling (economy cycle) and cut down on out-of-hours operation. Many cooling towers use more water than necessary and energy savings from more appropriate water usage can be substantial.

PCs

A modern PC with a large monitor could easily add 300W or more to your electricity usage and help to heat up the office. PCs should be turned off when not required. There is no support that turning computers on and off will damage the hard drive. (Screen Savers merely 'blank' the screen.)

Compressed air

Air might be cheap, but compressed air is anything but cheap. The first rule of compressed air savings is to try to find an alternative: a pneumatic drill for example will use an order of magnitude more electricity than an electric drill. If compressed air equipment is a must there is good scope to save energy by:

- checking for and repairing leaks,
- making sure the system is operating at the lowest acceptable pressure;
- Using automatic isolating valves to isolate areas of the system that are not required; and, Turning off compressors after hours.

Electric Motors

If your motors run for more than 4,000 hours per annum, a High Efficiency Motor (HEM) should be used instead of a standard motor. Even if motors run for less than this amount, HEMs should be considered instead of a rewind. The HEM will very often offer genuine long-term savings.

More cost savings can be made by correctly sizing motors. Motors that are larger than necessary won't last longer than a correctly sized motor, but they will use more energy.

Variable Speed Drives (VSD)

Always use a VSD for flow control instead of a throttling valve or similar. For example payback of a VSD over a throttling valve that reduces flow by more than 50% could typically be less than one year.

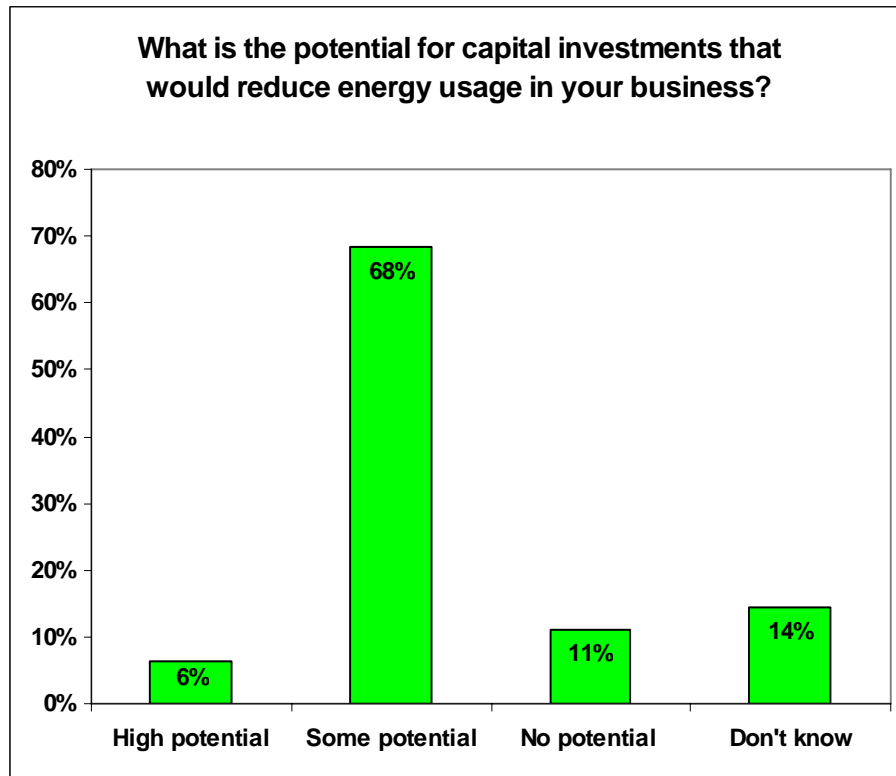
Steam

Steam is often the most expensive way to heat a product and alternative should always be considered. If there are no alternatives energy can be saved by making sure steam pipes are well insulated, watch for leaks and keep pressures and temperatures to the minimum acceptable levels.

What abatement measures are currently available with a significant injection of capital expenditure?

Snap Survey Question

In our Snap Survey (see Appendix 1) we asked businesses about the potential for capital investments that would reduce their energy usage. Only six percent indicated that such measures were readily available while a further 68 percent indicated that there was “some potential” for such investments.



We asked the Australian Industry Group’s Energy and Sustainability Help Desk for information about the availability of energy-saving capital investments. While noting that the suitability of such investments was highly dependent on the specific circumstances of different businesses, the Help Desk identified co-generation; forestry offsets; replacement of old equipment; heat recovery measures and plant redesign as leading contenders.

In some of these cases, such investments were generally prohibitive given existing prices.

Appendix 1 Ai Group Snap Survey

Ai Group sent emails to senior managers of around 500 member companies inviting them to respond to an online survey. We received responses to all questions from 64 people.

While we do not regard this as a rigorous sampling tool, we do regard it useful as an indicative tool and as a pointer for further investigation.

Questions

1. In your investment decisions, how closely does your business consider the possibility of stricter regulation of emissions of greenhouse gases?

- Very closely
- Somewhat
- Not at all
- Don't Know

2. How much is uncertainty over future regulation of greenhouse gases a barrier to more effective planning in your business?

- Very much
- Somewhat
- Not at all
- Don't know

3. What is the availability of low-cost measures that would reduce energy usage in your business?

- Readily available
- Somewhat available
- Not available
- Don't know

4. What is the potential for capital investments that would reduce energy usage in your business?

- High potential
- Some potential
- No potential
- Don't know

5. Is your business currently impacted by measures regulating the emission of greenhouse gases?

- Yes
- No
- Don't know