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Committee Secretary
Senate Standing Committees on Environment and Communication
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Dear Secretary

The Australian Industry Group welcomes the opportunity to provide a submission to the Senate Standing Committee on Environment and Communication's Inquiry into the Clean Energy Legislation (Carbon Tax Repeal) Bill 2013 and related bills. Ai Group recently provided a submission to the Government on its draft legislation, and we reiterate much of that input below in response to the legislation as introduced.

Ai Group represents a diverse range of businesses with many perspectives on the carbon tax. Our membership encompasses more- and less-intensive energy users; energy generators and suppliers to the energy sector; both trade-exposed and purely domestic industries; and enterprises large and small. These businesses have been impacted by the carbon tax in many different ways, and the impacts of repeal will take just as many forms.

Ai Group has been closely involved in climate policy discussions for many years. Our long-standing principles for sound climate policy are reproduced at **Attachment B**. We have been critical of the present carbon tax since it was first proposed; in particular, the tax is far too high in light of international prices and the imperative to minimise the national cost of meeting Australia's emissions goals.

It is clear that the carbon tax will be removed. But delay and uncertainty about the timing would impose unnecessary cost and confusion on industry and households, primarily through the electricity market. We have argued that delaying the inevitable achieves nothing, and that the Parliament should come together to remove the tax and agree on how to meet the bipartisan emissions targets at least cost to the nation. Additional comments on the proposed legislation and related policy are at **Attachment A**.

For any questions about this submission, the appropriate contact is Tennant Reed (03 9867 0145, tennant.reed@aigroup.asn.au).

Yours sincerely,

A handwritten signature in blue ink that reads "Innes Willox". The signature is written in a cursive style and is underlined with a single horizontal stroke.

Innes Willox
Chief Executive

ADDITIONAL COMMENTS ON THE BILLS AND RELATED POLICY

From Ai Group's discussions with member companies and other stakeholders, it appears that the most significant short-term complications in the repeal process will arise if it is completed retrospectively following a delay of uncertain duration past 30 June 2014. This would have implications for electricity price pass-throughs, the invocation of change-of-law clauses in a range of commercial contracts, and potential subsequent refunds or reversals. While the Government has indicated it does not wish to intervene in private commercial arrangements, these matters should be subject to further consultation in the event that delay looks likely.

For most businesses the main source of impact from the carbon tax has been through energy prices, particularly electricity. An Ai Group survey conducted in 2012 found that businesses in the manufacturing, construction and services sectors estimated an average increase of around 14.5% in their energy costs as a result of the carbon tax. However, the pass-through of savings following repeal may not be as large or as fast. Energy prices have risen and are continuing to rise for other reasons, particularly large increases in electricity network costs and a dramatic increase in wholesale gas prices; the proportionate impact of removing carbon costs will likely not match the impact of their introduction. Furthermore, hedging arrangements by electricity retailers and carbon-inclusive energy supply contracts entered into by many businesses will embed carbon costs over a longer period. These matters should be kept firmly in mind, particularly by the Australian Competition and Consumer Commission in carrying out its price monitoring role.

The ACCC and the Government more generally should also be aware that outside of energy prices, carbon price pass-throughs have been limited and the impacts of repeal will also be limited. An Ai Group survey earlier in 2013 found that 70% of businesses in the manufacturing, services and construction sectors were unable to pass through any of their carbon-related energy cost increases to customers. The remainder of the sample were able to pass through small amounts of their carbon cost. Across all businesses, just 6% of total carbon costs were estimated to have been passed on to customers. This strongly suggests that the ACCC should be cautious and focussed in its price monitoring role, as significant price movements are only likely in the area of electricity and gas.

The treatment of Synthetic Greenhouse Gases looms as a particularly complicated issue. The imposition of an equivalent carbon price on these gases via an increase to the existing levy on their manufacture and import has left manufacturers, importers and servicers of refrigeration and other relevant equipment with stocks of gases on which the levy has already been paid. These businesses will be unable to recover these costs under current proposals. Furthermore, many businesses have begun to transition away from high global warming potential gases towards alternative refrigerants. Australia and other G20 nations have also agreed in principle to phase out the use of hydrofluorocarbons through amendments to be negotiated to the Montreal Protocol. The Government should develop arrangements for dealing with existing SGG stocks and for providing suppliers and users of refrigeration equipment with a clear long term policy framework.

Existing assistance arrangements relating to the carbon price should be maintained in full for as long as they are needed. The proposed arrangements for the conclusion of the free allocation of emissions units under the Jobs and Competitiveness Program to Emissions Intensive Trade Exposed industries are broadly satisfactory. However it will be important to ensure that activities still in the process of recognition as EITE are fully included in allocations for 2012-13 and 2013-14.

JCP has been of great importance but covers only the most emissions intensive activities. The Clean Technology Program has covered a much broader array of manufacturers, many of whom have been under intense competitive pressure. This program has made a significant contribution to maintaining many businesses' competitiveness at a time of sharply rising energy prices, including the impacts of carbon pricing. Manufacturers will continue to pay the carbon price at least until 30 June 2014, and potentially longer given the potential for delays in legislation and electricity price impacts. However the Clean Technology Program has been frozen since the recent election, with no new grants being made and many meritorious applications in limbo. While the Clean Technology Program is not part of the legislative package now being debated, Ai Group has strongly urged the Government to continue the program in full at least until 30 June 2014.

Finally, we note that the proposed repeal legislation has implications for the Renewable Energy Target. The removal of the carbon price can be expected to increase the price of Large-scale Generation Certificates, partly offsetting electricity price impacts; if this causes LGC prices to hit the penalty price, there would be implications for achievement of the target. We note that the legislation would continue the current biennial review of the RET, rather than moving to quadrennial reviews as had been foreshadowed by the former Government's response to the 2012 RET Review. All these matters should be considered by the new RET review, to be conducted in mid 2014.

Ai Group Climate Policy Principles

The Australian Industry Group's key climate policy principles are, at their highest level, centred on the preservation of competitiveness; least cost abatement; energy security; fostering research, development and deployment of low-carbon technologies; and minimisation of compliance burdens. These top-level principles have more detailed implications, like the need for climate policy to avoid simply adding to general-purpose revenue.

Ai Group's National Executive has endorsed the following framework as a basis for assessing proposed climate policies. Bolded text is a principle, underlined text is an elaborated sub-principle, and subsequent text is explanatory.

1. Australia should ensure that its emissions reduction effort is in line with the action and ambition of other major economies.

This includes taking into account the extent to which major emerging economies are constraining their emissions and whether efforts by advanced economies are comparable to our own.

Australian climate policy should be flexible so that it can be adjusted in response to the actual level of emissions reduction action and ambition in major advanced and emerging economies.

For example, weaker action or ambition in these economies should lead to lighter burdens on Australian business. Conversely, policy should be able to strengthen if warranted.

Australia should develop and promote a credible basis for assessing and comparing the efforts of different countries. Regular reviews are needed.

2. The competitiveness of Australia's trade-exposed industries cannot be eroded.

- a. Global action is fundamental to preserving Australian competitiveness and should be actively promoted in international forums. The starting point for maintaining competitiveness is global action. Even strong measures aimed at trade exposed industries cannot maintain Australian competitiveness over the long term without global action; eventually, the burdens of maintaining such policies while cutting national emissions would become insupportable. Governments should use every opportunity, including through the G20 to push for global action.
- b. Neither Emissions Intensive Trade Exposed industries nor the broader trade exposed sector should be unfairly disadvantaged against overseas competitors while global action remains patchy. All major economies have pledged targets or actions, but while mostly significant, these are not yet sufficient to prevent serious competitive impacts from an Australian carbon constraint. Strong measures are

needed to maintain the position of Australia's most vulnerable industries against unconstrained competitors. While different specific measures may be appropriate for the most emissions intensive industries and for the broader trade exposed sector, measures for the latter should be no less effective.

- c. Policy should build Australia's long-term competitiveness, including in energy. Even under a globally consistent carbon constraint, long-term Australian competitiveness will be damaged unless we adapt effectively to a low carbon global economy. An important part of this will be ensuring a continuation of Australia's advantage in relatively cheap energy. Policy should support an efficient pathway to energy sources that will be globally competitive in the long term under a carbon constraint, whether that turns out to mean gas or coal with carbon capture, renewables, or even nuclear energy. Investments in infrastructure for the transmission and distribution of energy must modernise these systems to capture the benefits of decentralised generation, greater flexibility in fuel sources, and effective management of demand and supply.
- ### **3. Australia should be able to meet its international emissions reduction commitments at least cost.**
- a. Policy should cover the broadest practical base of emissions. The more emissions are covered by policy, the more widely abatement action and costs can be spread. While practical factors may narrow the base, this intensifies the abatement burden for covered sectors.
 - b. Policy should drive all credible and internationally recognised forms of abatement. Many forms of abatement are available: reductions using existing or future technology to improve carbon efficiency, sequester carbon in the landscape or change energy generation; behaviour change; and imported abatement. Minimising costs requires that all these options be open and that they compete for resources on a common basis. The economic cost to Australia of emissions reduction is only justified if it contributes to an international mitigation effort that reduces climate change. If we rely on abatement that is not recognised as meeting Australia's commitments, we must either undertake additional abatement at further expense, or risk undermining the international framework that justifies the cost of abatement.
 - c. Market mechanisms will generally be most efficient in locating and driving least cost abatement. While regulation or direct government funding can have a role in some circumstances, bureaucratic or political decision making are usually poor substitutes for the judgments of market actors responding to price in light of their own circumstances.

- d. Complementary measures should be adopted only where they can achieve abatement at lower cost than market mechanisms, or enable markets to work more efficiently. Markets will not work in every instance, and they can be made to work better – for instance through measures to address information gaps or agency problems. Such interventions should be chosen with care to ensure they actually minimise costs.
- e. Any interim measures preceding a long-term climate policy should be consistent with longer-term policy directions, have acceptable start-up and phase-out costs and must achieve least cost abatement, including on a net present value basis, to ease the transition to longer term policy. There is a role for interim measures in the lead-up to a long-term mechanism, but these can easily turn out to be high-cost or more trouble than they are worth to bring in and phase out.
- f. Distortions and perverse incentives should be minimised, especially those that discourage early movers. While climate policy is intended to correct a market failure, it can easily introduce failures and distortions of its own if not carefully designed. Abatement incentives can be positive or negative, but they must be allowed to operate, rather than being blunted, if abatement is to be least cost. Policy must also avoid creating incentives to defer or drop abatement investments that would most efficiently be made now.
- g. Climate policy should not increase the state share of GDP, and any resulting revenue should either be returned to individuals and business, or used where necessary and cost-effective to address legitimate needs directly related to climate policy. Some plausible forms of climate policy would raise revenue for the Government, but simply increasing state revenue and general spending is likely to detract unnecessarily from growth, dynamism and overall welfare. Climate policy will entail important spending needs, such as assistance to households and severely affected industries to address equity concerns, assistance to trade-exposed industries to address competitiveness impacts, funding for research and development, and other matters directly related to climate policy. Any such spending should be efficiently designed to minimise the overall costs of mitigation, and any surplus should be returned to the economy – including through reductions in other taxes.

4. 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

- a. A clear, predictable and well designed long-term policy is vital for business to make efficient long-term investment. Perfect certainty is unachievable, and the quality of policy is vital, but there is no doubt that

substantial uncertainty over the timing and direction of climate policy is a serious barrier to investment in energy and other major industries across the economy.

- b. Policy should provide a clear and supportive environment for new energy investment. The problems of policy uncertainty are especially serious in the energy sector. Forward looking investors need reasonable confidence about the regulatory environment that will apply over the life of their investment. That environment must be a supportive one, however, if investment is actually to result.
- c. Any carbon pricing policy should balance price certainty and flexibility. Price flexibility allows savings if abatement costs are lower than projected, and a better match with changing economic conditions. However, too much volatility and price risk – on both the upside and downside – will harm investment.
- d. Policy should smooth shocks in the energy sector, ensure that any generation exit is orderly and satisfy existing investors' legitimate expectations. Sudden shocks from climate policy may cause intense difficulties for some generators. This would mean risks to near-term energy security, impose serious loss on existing investors, increase the cost of transition and dissuade future investment. Policy should smooth shocks and satisfy investors' legitimate expectations. The impacts of structural adjustments in the energy sector on affected companies and communities must also be addressed.

5. A central feature of policy should be supporting research and development of new approaches to emissions reduction and refinement of existing approaches.

- a. A market for low-carbon goods and services is necessary for broad-based innovation. The development of low-carbon products and technologies will be severely constrained unless innovators are confident that a low-carbon product will be more profitable than a high-carbon substitute. The existence of an actual market is a more plausible spur to innovation than the unpredictable availability of year-to-year grants or subsidies.
- b. Additional support is needed to reflect spillover benefits from carbon innovation and the high costs of commercialising some new technologies. Even with a market reward, low-carbon R&D produces benefits for society at large that the researcher cannot capture. If R&D is not to face underinvestment, further assistance will be needed, whether through the tax system, grants, prizes or otherwise. Some promising technologies, including renewable energy technologies and carbon capture and storage, require significant support through demonstration and deployment phases if they are to achieve their potential.

6. Compliance costs and regulatory burdens should be kept to a minimum.

- a. Policy should achieve maximal coverage with a minimum of parties directly involved or regulated. While all Australians and companies are responsible for greenhouse emissions to some degree, administrative costs and burdens would be insupportable if more than a small fraction of emitters were directly regulated or liable under carbon policy.
- b. Policy should rely on existing data and reporting systems wherever possible, with any new processes imposing the minimum additional burden necessary for good governance. While policy needs information to operate, a great deal is already collected and new requirements for additional or slightly different data can easily become very costly. Processes to judge difficult concepts like ‘additionality’ are especially likely to be expensive, time consuming and inflexible.
- c. Policy should drive the elimination and avoidance of unnecessary, duplicative and unduly burdensome climate regulation. A vast array of largely uncoordinated climate policy already exists and the political incentive for more is constant. Much of this would be unnecessary or avoidable under a broad long-term policy.