NSW Trade Exposed Emissions Intensive Industries Summit

Issues Paper

DISCLAIMER

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Background

The introduction of an Australian emissions trading scheme (AETS) by the Commonwealth Government will for the first time place a national cost on greenhouse gas emissions. This is expected to include energy generated emissions as well as fugitive emissions. Further significantly increased mandatory renewable energy targets (MRET) will together with the AETS lead to higher electricity and other energy costs.

Rationale for TEEIIs assistance

The introduction of the AETS will particularly impact on emission intensive industries. In the absence of a global emissions trading scheme, industries that are trade exposed, either through export and/or import competition, may not have the ability to recover such costs in the global market place.

The Commonwealth Government has not yet proposed a definition of "trade exposed emission intensive industries (TEEIIs)" for the purpose of the emissions trading scheme. It is possible, but by no means certain, that the definition of a TEEII could include some of the following industries: aluminium, steel, chemicals, plastics, cement, glass, paper, petroleum refining, LNG, petroleum refining and other processing industries and also agricultural industries such as livestock, and sugar and its refining.

Energy and emission costs are typically prominent factors in TEEIIs' decisions about building new facilities. Placing a price on the right to emit carbon, coupled with increased energy costs from a higher mandatory renewable energy target, could give rise to "carbon leakage", i.e. lower investment in Australian TEEIIs and increased investment in countries not subject to carbon constraints. Australian TEEIIs compete against industries in the developed and developing world where there are currently no significant greenhouse gas emissions penalties being imposed. There may be little or no net global greenhouse environmental benefit in locating these industries in such countries rather than in Australia. Hence the economic cost to Australia of "carbon leakage" could be to little or no global environmental benefit.

The NSW Government strongly supports the position that the Federal Government should provide transitional financial assistance (possibly in the form of free permits) to account for distortions arising from major trading competitors not adopting emissions limits (or pricing). 'New' TEEII plants should also be eligible to receive appropriate transitional assistance, consistent with the rationale that overseas competitors are not subject to equivalent constraints on emissions.

Industry's concerns

In submissions to other forums, such as Garnaut Review and the National Emissions Trading Taskforce, industry representatives have already raised a number of concerns in relation to the treatment of TEEIIs under an emissions trading scheme. A brief summary of these are included below:.

The overarching issues for industry arising from the advent of ETS (Australian and international) include factoring in the:

- increased costs and new uncertainties into the firm's global investment decision i.e. the effects on comparative attractiveness of Australia for future investment in these industries;
- impact on investment in R&D and innovation in Australia;
- increased costs and uncertainties from the AETS into the firm's operating decision e.g. whether to upgrade, business as usual, run "cash-cow" strategy, cut back production or shut down?

Specific issues for industry include:

Mandatory Renewable Energy Target (MRET)

The Commonwealth Government's proposed MRET may further add to electricity price increases. TEEIIs could be particularly impacted on and will not have the ability to recover any such costs in the global market place until such time as international competitors face similar cost impositions. The NSW Government had intended to exempt TEEIIs from the impact of the proposed NSW Renewable Energy Target (now overtaken by the Commonwealth Government's plans) – should an exemption or transitional financial assistance be part of the Commonwealth Government's MRET?

TEEIIs coverage – emission intensity

What is the most appropriate measure to define emission intensity, and what should be the qualifying threshold for the emission intensity measure? Should it be 1,200tCO2-e/A$M of revenue (including indirect emissions from electricity consumption), as suggested by the National Emissions Trading Taskforce (NETT) as a starting point for further discussion, or another threshold?

Is there need for different baselines for existing plant, fugitive emissions, new TEEIIs investments, plant expansions and upgrades?

Should the intensity measure be applied on a "product by product" basis?

TEEIIs coverage – trade exposure

Should all TEEIIs exports be compensated, or only those destined for countries that do not comply with Kyoto? If TEEIIs are compensated in competitor jurisdictions that have carbon pricing in place, how should this be taken into account?

Even in compliant export markets, Australian exporters may compete with products from non-compliant countries ("third party" competition). Should these markets qualify for TEEIIs provisions? What is a suitable metric and threshold for trade exposure?

Should TEEIIs exposed to some import competition from non-Kyoto compliant countries receive assistance? What is a suitable metric and threshold for import competition?

Phasing out assistance

Should phase out approaches be defined in advance, and when should it occur? Should phase out commence when only some or wait until all competing nations (including "third party" competitors) have equivalent carbon costs?

Assistance provisions
In what form should assistance be provided e.g. viz. permit allocation, AETS exemption for TEEIIs in covered sectors, or other?

Another mechanism for industries competing with imports may be the use of tariffs on imports from non-Kyoto compliant countries, subject to consistency with WTO and FTA obligations

Flow on effects on industry
In addition to the direct cost of carbon for emissions generated through a TEEIIs manufacturing processes, there may be flow-on costs resulting from the introduction of a carbon price – such as increases in prices for raw materials, distribution, fuel and electricity may be passed directly to a TEEIIs. Depending on the price elasticity of demand for their products, the affected TEEIIs may have limited ability to pass these additional costs on to their customers. Should the impact of a carbon price on the cost of inputs be taken into account in any assistance mechanism for TEEI firms? If so, how?

Certainty
It is recognised that certainty about the future price of emissions is not possible under a cap and trade system, though it is expected that financial derivatives may become available which will provide some scope for hedging future prices.

Property rights
Permits allocated as assistance to TEEIIs could be structured so as to give their holders firm property rights. This means that the holder of a permit has a clear right to emit. It also implies that decisions by governments to take away permits (or undertake actions that de-value them) may require compensation.

Linkage to ongoing improvements
Should allocations to TEEIIs be linked to ongoing improvements in emission intensity of production until such time as competitors adopt similar emission penalties?

Tax treatment
The tax treatment of allocated permits needs to be defined, not only before scheme commencement, but also before estimating equitable allocations for assistance. Attention should be given to the taxation issues that would arise, including complex interactions with international tax agreements and treatment by other countries.

World Trade Organization (WTO)
There is a need for WTO compatibility for any TEEIIs assistance provisions.

Government issues

The overarching challenge for the Federal Government is to implement an AETS that:

- meets emissions targets over the next several decades;
- minimises any brake on GDP growth;
- achieves the substantial economic adjustments required at least cost, dislocation and disruption to the economy including the impact on employment in regional communities;
- avoids investment paralysis and energy supply shortfalls;
- reflects careful consideration of sovereign risk implications;
- encourages investment in innovation and new technologies; and
- includes TEEIIs provisions that avoid possible unintended perverse consequences like favouring competing products in the domestic market and net increases in emission intensity.

Specific issues for Government include:

Impact on regional Australia

The NSW Government is conscious of the impacts the AETS may have on regional NSW. Regions such as the Illawarra and the Hunter are particularly exposed, as the coal, steel and aluminium smelting industries (and their supporting infrastructure) are significant contributors to the regional economies. BlueScope Steel is the Illawarra's largest employer, while the Tomago Aluminium smelter is one of Hunter's largest single site employers. Similarly, other TEEIIs industries are very significant contributors to the economies of regions throughout Australia.

Flow-on effects to the economy

In addition to the impact of the AETS directly on the TEEIIs there will be upstream and downstream flow-on effects to other participants in the economy.

Modelling

Governments must be realistic about the enormity of the challenge of producing robust estimates of ETS impacts. While good modelling can valuably illustrate the scale of economic risks, governments are well served by modesty in relation to the quality of their knowledge about the future outcomes in complex systems.

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