

**SUBMISSION TO
GARNAUT CLIMATE CHANGE REVIEW, ISSUES PAPER 2,
FINANCIAL SERVICES FOR MANAGING RISK
CLIMATE CHANGE AND CARBON TRADING**

**A3P
THE AUSTRALIAN PLANTATION PRODUCTS AND PAPER INDUSTRY COUNCIL.**



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This submission to the *Garnaut Climate Change Review, Issues Paper 2, Financial Services for Managing Risk: Climate Change and Carbon Trading* is made on behalf of the plantation products and paper industry by A3P – the Australian Plantation Products and Paper Industry Council. A3P welcomes the opportunity to make a submission.

SUMMARY

This submission by A3P on behalf of the plantation products and paper industry emphasises the following points:

- Free allocation of permits to a firm suffering increased costs but not responsible for the emissions, would not hinder price discovery
- An emissions trading scheme should be designed to be as broad as possible and should impose minimal transaction costs.
- A demonstrably stable policy environment and secure property rights are essential components of harnessing the power of commercial markets.
- A known forward price curve and the availability of financial derivatives are essential tools for liable entities to manage risk.
- Banking does not compromise the environmental integrity of the policy and should be allowed unfettered.
- Borrowing a small numbers of permits at the margin to assist with end-of-year reconciliations of actual emissions and permits would improve flexibility
- Australia should continue to lead international efforts in the development and application of robust and credible methods of tracking carbon in forests and wood products.
- Measures should be introduced that maintain competitiveness of Australian industries compared to overseas counterparts for the period that competing countries do not impose an equivalent carbon cost, while still maintaining appropriate carbon price signals in domestic markets.

BACKGROUND

A3P is the peak representative body for the Australian plantation, plantation products and paper industry. A3P's 30 member companies have sales revenues of more than \$4 billion per annum and directly employ 13,500 people predominantly in rural and regional Australia in centres such as Mt Gambier, Morwell, Tumut, Albury, Oberon and Gympie.

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The three sectors of A3P's membership are faced with different opportunities and threats by climate change and Governments' response including a possible emissions trading scheme.

- The pulp & paper sector is a significant user of energy, particularly in mechanical pulping processes, and is faced with strong competition from imported product from countries such as China, Brazil, Indonesia and Korea. The sector is also a producer of renewable energy using processing waste such as black liquor from chemical pulping. This renewable energy may be used on-site or exported to the grid. The pulp & paper sector used more than 50 000 TJ of energy in 2005-06 with more than 12 000 TJ produced from renewable sources on-site.
- The solid wood sector is an energy user and a producer of renewable energy from residues, most of which is used on-site for timber drying. Sawntimber stores carbon and has a significantly lower global warming potential than competing building materials.
- The plantation growing sector manages significant carbon sinks. Plantation expansion is contributing to Australia's performance against our Kyoto target and there is potential for increased activity through appropriate market responses to climate change.

The three sectors are strongly linked through supplier/customer relationships, corporate structures and market arrangements. Positive and negative impacts on one sector inevitably flow through to other sectors.

A3P members comprise 30% of the total elective participants in Australia's only current emissions trading scheme (NSW GGAS). This level of participation is the largest of any sector. A3P is therefore able to draw on extensive practical experience when commenting on proposed emission trading schemes.

A3P accepts that human-induced climate change is real and requires urgent and substantive action on a large scale. Work must continue on the scientific understanding and predictions but enough is currently known to justify action.

Emissions trading, if designed well, can be an important component of the response and will be more efficient than the current arrangement of conflicting and duplicative Government programs.

A3P members have been involved in current Australian and international emissions trading schemes. This includes a number of A3P members being benchmark participants in the NSW GGAS scheme, and members with operations in countries working under the European trading scheme.

STRUCTURE OF THIS SUBMISSION

This submission does not seek to comment on all the issues and questions posed in the Issue Paper. It responds only to those issues of direct interest to the plantation products and paper industry under the broad subject of managing risk within carbon trading.



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Free allocation of permits and price discovery

The Issues Paper notes that free allocation of permits may result in fewer permit trades and hinder price discovery.

The specific instance of free allocation of permits to a trade-exposed, emissions-intensive firm where the bulk of those emissions are Scope 2 (purchased electricity), warrants closer examination. In this case the firm would be allocated permits to offset an increase in electricity costs and would only receive the quantity of permits deemed necessary to offset the added costs that could not be passed through to customers. The firm would not need to surrender the permits directly but would be expected to trade them in order to generate a compensating revenue stream.

In such a case, the free allocation of permits to a firm suffering increased costs but not responsible for the emissions, would not hinder price discovery. This case applies to many of the likely trade-exposed, emissions intensive industries and represents a significantly different situation to the European example where coverage extended to electricity generation and permits were allocated directly to the liable parties to the maximum extent of their liability. This created a windfall gain as they were also able to recover additional revenue by passing costs through to customers.

Efficient markets

Emissions trading is a powerful policy response to climate change as it harnesses the scale and innovation of markets to find the least cost abatement. Capturing this strength requires freedom for a range of organisations to actively participate in the market, offering abatement in various forms. It follows from this that an emissions trading scheme should be designed to be as broad as possible (to capture the maximum breadth of abatement possibilities) and should impose minimal transaction costs (so that abatement can be offered in a variety of forms and scales).

It is acknowledged that climate change is a long term challenge requiring long-term policy responses, significant changes to the way we produce and consume, and major technological innovations. If the market, through emissions trading, is to be a core part of the policy response then it is essential that the rules governing that market are clear, unambiguous, stable and free from political interference. Emissions trading is intended to provide incentives for commercial action much of which, including research, development and capital investment, will only provide adequate returns over many years. A demonstrably stable policy environment and secure property rights are essential components of harnessing the power of commercial markets.

Forward markets

The Issues Paper correctly notes that “it is the forward markets that are likely to drive long term efficient investment decisions and drive emissions reductions”. It is also pertinent to note that forward markets are a vital component of risk management for liable entities.

A known forward price curve and the availability of financial derivatives such as forward contracts, swap contracts, options, etc ensures that the carbon cost



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is considered and can be effectively managed for existing and planned investments rather than creating a level of risk that may impede otherwise appropriate investments.

The option of banking of excess permits will enable businesses to effectively manage their exposure, particularly where emissions and abatement vary from period to period. Banking will also be important for (small) forest offset providers where credits are created incrementally over a number of years and it would be more efficient to accrue credits for a number of periods before selling them on the market. Banking does not compromise the environmental integrity of the policy and should therefore be allowed unfettered.

As the Issues Paper notes, there is greater cause for concern that borrowing of future permits could create problems of delayed action or future liabilities. It should be noted that a robust framework for borrowing does not necessarily undermine the environmental integrity of the policy given the long time frames required for action and the long-term impact of greenhouse gas concentrations. Whatever decision is made on borrowing of future permits, the scheme will be more workable if there is at least the option of borrowing small numbers of permits at the margin to assist with end-of-year reconciliations of actual emissions and permits.

Australia as a regional hub in the Asia Pacific Carbon Markets

A3P concurs that Australia has an opportunity to become a leader in emerging carbon markets. In addition to the ideas proposed in the Issues Paper, A3P suggests that Australia should continue to lead international efforts in the development and application of robust and credible methods of tracking carbon in forests and wood products. There is a particular opportunity to demonstrate how forests offsets and the carbon stored in timber can be successfully integrated into an emissions trading scheme.

International and domestic competition

The introduction of a carbon cost is intended to change the relative competitiveness of competing products or services on the basis of their emissions profile. This is fundamental to the objective of the policy. It creates the market signal that brings about the behavioral change needed to reduce emissions.

However, the introduction of a carbon cost in some countries and not others changes the competitiveness between products based on their country of origin, not their emissions profile. This is contrary to the policy objective, damaging to the economy, and will not lead to reductions in emissions. Measures should be implemented to minimise or eradicate this effect.

The plantation products and paper industry has a specific set of circumstances surrounding trade-exposed, emissions-intensive industries that may be unique but is also indicative of the challenge facing policy makers. The challenge to policy makers is to introduce measures that maintain competitiveness of Australian industries (such as paper, steel and concrete) compared to overseas counterparts for the period that competing countries do not impose an equivalent carbon cost, while still maintaining appropriate carbon price signals in domestic markets where low-greenhouse-impact products (such as



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timber) compete against high-greenhouse-impact products (such as steel and concrete).

The Australian paper sector competes against imports from countries that are unlikely to introduce a carbon cost (Indonesia, China) in the near future. Australian paper producers will suffer a loss of market share, profit and investment if no measures are implemented to maintain their competitiveness under a localised carbon cost. However the Australian sawntimber sector faces competition from locally produced steel and concrete and reasonably expects the introduction of a carbon cost to increase timber's competitiveness as result of its lower greenhouse footprint. This would not occur if trade-exposed, emissions-intensive measures are implemented for steel and concrete.

In this instance, a solution is to ensure that the carbon stored long-term in timber products is acknowledged under an emissions trading scheme. As a result timber would gain a competitive acknowledgement from at least part of its superior greenhouse footprint.

Thank you for the opportunity to provide a submission on the Issues Paper. I look forward to further engagement with the Garnaut Review on these issues. If you have any questions please contact Miles Prosser on 02 6273 8111 or miles.prosser@a3p.asn.au

Yours sincerely



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