

Submission to Garnaut Climate Review, Emissions Trading

Ben Rose,

Environmental Consultant

Comments (highlighted in yellow) on Executive Summary Points

Permit Allocation: The price of permits, the increase in the price of electricity and other emissions-intensive products, and structural change in the economy in response to the restriction on emissions, will not be affected by the method of permit allocation. Transaction costs will be lowest if they are auctioned; any free allocation of permits will involve elaborate assessment and political processes

1. Auctioning is the best option, to ensure that inefficient generators are not subsidized.

Trade-exposed emissions-intensive industries (TEEIs): Until our major competitors have broadly similar emissions constraints, payments to TEEIs are justified for reasons of environmental and economic efficiency. Payments should be calibrated in a timely and precise way to the effects on the value of sales of particular commodities.

2. Aluminium smelting accounts for 5.9% of Australia's emissions and producers pay less than 2.7 c per kWh for the coal fired electricity used (compared to normal industry prices of 6 – 7c and domestic price of 13 c (Australia Institute, 2003, attached). It is essential that this industry is not excluded from the carbon tax – it more than any other industry must pay much more for its electricity as it is such a large emitter. To protect this industry while imposing costs on all other sectors would be politically unacceptable

Aluminium smelting at Portland uses the most CO₂ polluting power source in the world brown coal. This industry should not be protected but become competitive with the same rates paid by other industries with a carbon tax or move offshore to a location where there is excess hydro or nuclear power capacity. The existing Government subsidies enabling the <3c/ kWh electricity to be provided to Alcoa should be removed and the carbon caps applied ASAP. The extra emissions from shipping bauxite to Africa, Asia, or the US are a small fraction of the emissions saved by using these cleaner power sources

Automobile manufacturing Industries producing large inefficient cars at Melbourne, Adelaide and Geelong should receive no more Government assistance or protection in their current form. They should either produce a plan to re-tool ASAP to produce cars that use 50% or less of the fuel used by current models or close down. It is unlikely, given the economies of scale that small fuel efficient cars can be produced economically in Australia and the money would probably be best spent on assisting research and development projects for sustainable transport.

Fed. Govt. should promote alternative sustainable industries in these manufacturing areas by providing assistance for such ventures as solar, wind and geothermal generation equipment manufacturing.

Compensation: This is a difficult reform, and a permit price that is high enough to secure levels of emissions within targets and budgets will have major effects on income distribution. The losers from such changes (households, and low-income households in particular, but in some circumstances domestic and foreign shareholders in highly emissions-intensive businesses) may feel that they can make a case for compensatory payments.

3. *Investors in emissions intensive industries, like all investors are wealthy by world standards and should be subject to the 'buyer beware' principle. They can choose to invest elsewhere*

4. *In particular, coal fired power generation should not be compensated in the hope that carbon capture and storage will become viable, as it is becoming increasingly clear that will not be viable in most cases even with a carbon price of \$30 per tonne. It is also unlikely that existing power stations will be able to be retrofitted with CCS. Coal generators are likely maintain "token" CCS in order to get favourable treatment and justify prolonging their use of conventional coal generation and this should not be allowed.*

The case for substantial measures to reduce the impact of the reform on living standards of low-income households is strong, and will affect political support for and perceptions of stability of an efficient ETS. **Yes**

Also amongst the income distribution losers will be workers and communities dependent on emissions-intensive industries that may be unable to adjust readily to alternative employment. There is potential for disproportionate burdens to fall on coal-based energy-intensive regions, unless carbon capture and storage (CCS) technologies prove to be commercially viable at an early date.

5. *This is inevitable and these industries should have to adjust to the changes in their costs just as other commodities have had to adjust to major adverse changes to their terms of trade - e.g. agriculture several times worse terms of trade over last 40 years - without any compensation.* Assistance to established coal-based electricity generators with early testing and deployment of CCS would be a cost-effective, pre-emptive form of structural adjustment assistance.

6. *Investors and power plant owners alike have known a carbon price was coming for at least a decade since Kyoto and some will have been anticipating this 15 years ago after Rio.*

Compensating investors for poor investment decisions seems a strange way to behave. But then governments have also stepped in to support the sub-prime mortgage market where banks and investors made poor decisions. Knowing that a price on carbon was coming, perhaps coal investors were expecting compensation from Government??

Public finance: Alongside the generation of large amounts of revenue from permit sales, the Government will face large demands for increased expenditure associated with extrinsic features of the ETS.

Governments will need to assess competing priorities within a tight budget constraint. The political acceptability of the introduction of the ETS would be enhanced by

government commitment to transparently return to the community through the mechanisms outlined above or in other ways, all of the revenue generated by the sale of permits. **Yes**

Next steps: The Review is carrying out extensive economic modelling on the impacts of climate change, and the costs and benefits of mitigation and adaptation to climate change. The modelling will inform the full reports of the Review, scheduled for end June and end September. The Review will continue to engage with the public and the community on these issues as it finalises its full reports.

Summary of Australian ETS model for discussion:

| Design decision | Proposal |
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| Setting an emissions limit | <p>Government should set the emissions limit for Australia. This emissions limit should be expressed as a trajectory of annual emissions targets over time, which define long term budgets.</p> <p><i>Trajectories</i></p> <p>Four trajectories should be specified upon establishment of the ETS. The first up to 2012 will be based on Australia's Kyoto commitments. The other three for the post-2012 period reflect increasing levels of ambition. Movement between them should be based on determining the comparability of Australia's response to international effort.</p> <p>The Review will provide advice to government on trajectories and interim targets for an Australian ETS. This will be informed by economic modelling currently underway and further analysis, and presented in the full reports.</p> |
| Changes to the emissions limit | <p>Deciding to move from one trajectory to another should only be made on the basis of international policy developments and/or agreements (which should allow for new information and developments of an economic or scientific kind).</p> <p>Conditions which would lead to a movement from one trajectory to a more stringent trajectory would be specified in advance.</p> <p>Once on one trajectory, government provides five years notice before movement to another. Any gap between the domestic trajectory and international commitments during this period would be reconciled by the independent authority purchasing international permits.</p> |
| Coverage | <p><i>Gases:</i> Six greenhouse gases as defined by the Kyoto protocol.</p> <p><i>Sectors:</i> Stationary energy, industrial processes, fugitives, transport and waste from scheme outset. Agriculture and forestry to be included as soon as practicable. Action will be needed on all sources of emissions of all greenhouse gases – not just CO2.</p> <p>7. How to include international air travel emissions– about 3% of our emissions (see attached)? Australia should cover it with equivalent tax on air travellers until international agreement is made. This money should go into developing fast electric (wind-generated) rail links</p> |

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| | <p><i>between the capital cities starting with Sydney –Melbourne- Brisbane. The 300 kph commercial rail systems are being used commercially in Europe and could be installed in Australia and run competitively with air travel if perverse incentives were removed from the latter.</i></p> <p>8. How to include beef emissions – methane from ruminant digestion? Extend the C tax to domestic beef sales ASAP – be ready for a global emissions tax on beef. Mandatory emissions labelling of high emission food products such as meat is needed.</p> |
| Domestic offsets | <p>Domestic offsets should be accepted without limits, but will have a small role, given broad coverage.</p> <p>9. Please define domestic offsets. Offsets created by replacing old appliances with energy efficient ones e.g. CF light globes? Forest sink emissions? If so then these are best excluded as the voluntary offsets industry, which will continue to run in parallel with emissions trading, will provide a large market for them</p> |
| Point of obligation | <p>Set at point of emissions where practical. Where transaction costs are lower than the cost of distortions that may arise, upstream or downstream may be appropriate. Yes</p> |
| Permit issuance (or release) | <p>Permits released according to emissions reduction trajectory. All permits auctioned at regular intervals. Yes (Note, some permits may be used in lieu of cash in providing transitional assistance to traded-exposed, emissions-intensive firms at risk.)</p> <p>10. No, this must be minimal - see notes above; especially related to the grossly polluting aluminium smelting and bauxite production industries that are huge fossil fuel users.</p> |

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Design decision Proposal

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| International linkages | <p>Opportunities for international linkage of the Australian ETS should be sought in a judicious and calibrated manner. Yes</p> |
| Price controls | <p>Not supported.</p> |
| Inter-temporality | <p>Unlimited hoarding allowed. Official lending of permits by the independent authority to the private sector allowed, but may be subject to limits, in terms of quantity and time, determined by the independent authority.</p> |
| Treatment of TEEIs | <p>Some industries rely significantly on emissions-intensive production processes, and are substantially unable to pass costs of emissions through to customers because price of commodity or good is determined on international markets. Transitional financial assistance (possibly in the form of free permits) should be provided to account for distortions arising from major trading competitors not adopting emissions limits (or pricing).</p> <p>11. Make these transitional only; give them a deadline to clean up their act or move offshore.</p> |

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| Governance | Policy framework set directly by government. Scheme administered by independent authority. |
| Compliance and penalty | Penalty to be set as a compliance mechanism. Penalty does not replace obligation to acquit permits; a 'make-good' provision would apply. Alternatively, the use of revenue from a financial penalty could be used to purchase abatement. |
| Use of permit revenue | <p>Auctioning of all permits will be the source of a substantial amount of government revenue. Governments will need to assess competing priorities for this revenue, which may include:</p> <ul style="list-style-type: none"> ⌚ Payments to TEEIs (to correct for market failures); ⌚ Payments to households; ⌚ Structural adjustment to support declining communities; ⌚ Payments to firms to correct market failures in relation to new technologies; ⌚ Support for public infrastructure; and ⌚ Cash reserves to purchase international permits/offsets to reconcile domestic emissions with international commitments. <p>The political acceptability of the introduction of the ETS would be enhanced by government commitment to transparently return to the community through the mechanisms outlined above or in other ways, all of the revenue generated by the sale of permits. Yes</p> |

Additional comments – actions needed on transport fuel

12. In addition to the carbon price (which will amount to only several cents per litre and will not significantly affect demand) phased revenue neutral increase in fuel tax needed (for all road rail and marine and aircraft fuels) to a level equal to EEC average and keep in step with EEC.

13. Commercial trucks and tractors must be included – abolish diesel fuel rebate.

14. Compensate low income people by decreasing income taxes and or providing rebates.

14. All perverse incentives for use of fossil fuels for road transport and energy generation should be removed ASAP – these amount to \$ several billion per year. There will be increasing political pressure to do this when the public becomes aware of the magnitude of the existing subsidies