



**AIGN SUBMISSION TO
CLIMATE CHANGE AUTHORITY**

**SPECIAL REVIEW – SECOND DRAFT REPORT
‘AUSTRALIA’S CLIMATE POLICY OPTIONS’**

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ATTACHMENTS

Attachment 1. AIGN Policy Principles



1. Introduction

The Australian Industry Greenhouse Network (AIGN) welcomes the opportunity to respond to the Climate Change Authority's (CCA) Special Review: *Australia's Climate Policy Options*.

The key objective of any suite of climate policies must be to encourage long-term investment in reducing emissions via least-cost abatement activities. Importantly, whatever the policy or policies chosen to encourage emissions reductions, they must apply to the whole economy so that responsibility for meeting targets is shared equally by all sectors. Furthermore, Australia's policy approach must be conscious of competitiveness issues in considering the extent of, or lack of, a carbon price applying in competitor economies.

The stakes for AIGN members (who are the 'engine room' for many sectors of the Australian economy) on climate change are very high, and long-term policy stability and certainty is critical. This has obviously not been the case in recent years.

In participating in the climate change policy debate, AIGN bases its input on our policy principles (outlined in **Attachment 1**), which detail the manner in which we believe Australia's commitments and actions in relation to addressing greenhouse gas emissions should be shaped. Whilst AIGN does not promote any single policy measure, it does recommend a market-based, economy-wide approach to reducing emissions, potentially comprising a range of different policy measures that share the task of reducing emissions across the economy.

Noting that the Terms of Reference refer to issues concerning "*Australian businesses' international competitiveness*", an assessment of the implications of the Paris Agreement for Australian policy will be important. This should cover not only the provisions of the Agreement, but a thorough assessment of the commitments by our major trading partners as outlined in their Intended Nationally Determined Contributions (INDCs). This assessment must consider not only the measures and their economic implications in competitor economies, but also the timing of implementation; in other words, when commitments become concrete action. AIGN has provided a brief perspective on the Agreement below.

In considering this response, the CCA should note AIGN's broad range of members and resultant diversity of views on greenhouse and energy policy. While this response accords with the views of our members in general, at times there are variations in the positions of individual members on specific issues. It is therefore important that the CCA considers AIGN's comments alongside any responses made to this draft report by our members.



2. Climate Change & Australia's Response

Due to our endowment of natural resources and associated competitive advantage, Australia is home to a relatively large share of emissions-intensive production, resource and extractive sectors, particularly in relation to our population size. Arguably, this is an economically and environmentally efficient outcome from a global perspective, and could continue to be so in the future.

Australia's emissions in 2011 were around 1.3% of the estimated global total (including land use and forestry), and are declining as a percentage of global emissions, while total emissions from developing economies increase significantly. Climateworks noted recently that, "Since 1990, the overall emissions intensity of Australia's economy has almost halved and emissions per capita have decreased by approximately 25% over this period (ABS 2012, 2013a; DOE 2014)".¹

Australia is on track to meet its target under the second commitment period of the Kyoto Protocol. However, it should be noted that some of this achievement is based on a fall in economic activity, particularly in the manufacturing sector, which is contrary to the Government's intent of economic growth and increased investment. It is also not a desired outcome in terms of atmospheric greenhouse gas levels, since the reductions in Australia's emissions have been compensated by increases in other countries, commonly without a price on carbon or plans to introduce one in the near future.

AIGN has consistently advocated that Australia should make an equitable contribution, in accordance with its differentiated responsibilities and respective capability, to global action to reduce greenhouse gas emissions and to adapt to the impacts of climate change.

¹ *Pathways to Deep Decarbonisation*, Climateworks, 2015.

3. Consideration of Policy Options

AIGN notes the range of policy options put forward by the CCA in its options paper. Reducing emissions can be costly. Activities that give rise to greenhouse gas emissions occur across all sectors of society, and the domestic policies that underpin a post-2020 emission reduction target have implications for the nation's economic competitiveness and progress. While the effects of increasing levels of atmospheric greenhouse gases are felt globally, the impacts from the emissions reduction policies will be locally enforced and impact each sector of the economy differently.

An effective response to the challenge of climate change should aim to deliver abatement at the least-cost, be it through domestic abatement activity or through access to international opportunities. Depending on the structure of the policy approach, it will impose some costs for industry, as noted in the second Draft Report. To minimise these costs and any associated transfer of costs from one sector to another, it is vital that coverage be comprehensive across the economy, covering all greenhouse gases, all sources and all sinks.

As AIGN pointed out in its submission to the Caps & Targets Review issues paper, climate change policy development is complex for many reasons. Take for example, the difficulties involved in constructing policy instruments against the backdrop of scientific evidence on what needs to be achieved and by when. A major issue that can complicate this task is the mixture of objectives that need to be kept in mind when developing policy that responds fittingly to the conditions. Obviously the overarching goal is to reduce the atmospheric concentration of greenhouse gases, but beyond this there are three objectives that require consideration in shaping our policy response, to ensure the burden we are bearing is commensurate with the economic impact on other nations:

- Providing policy confidence to the market.
- Influencing other countries.
- Managing the impact of climate policies on the Australian economy.

While different stakeholders deem these objectives with varying levels of importance, all have their place in shaping Australia's policy response to climate change. Accordingly, climate policy options should be framed with the following overarching objectives:

- Encourage least-cost abatement and maintain international competitiveness.
- Provide policy predictability and stability.
- Provide a long-term approach.
- Be developed in a consultative manner.



Proposed policies should then be assessed against the criteria outlined in AIGN's principles (refer to *Attachment 1*). In particular, Australia should develop a strategic national approach to responding to climate change, which:

- is consistent with the principles of sustainable development;
- is consistent with other national policies, including those relating to economic growth, population growth, international trade, energy supply and demand, and environmental and social responsibility;
- takes a long-term perspective;
- maintains the competitiveness of Australian export- and import-competing industries;
- distributes the cost and responsibility of mitigation equitably across the community;
- adopts a consultative approach to the development of new policies; and
- is consistent and effectively co-ordinated across all jurisdictions throughout Australia.

AIGN considers that adoption of the above principles in developing future policy options would encompass the evaluation framework issues suggested by the CCA; that is, cost effectiveness, environmental effectiveness, and equity. AIGN also considers that, given recent experiences with policy uncertainty, it will be essential for the need for such certainty and stability to be highlighted as an important adjunct to any policy approach. The draft report downplays the issue of the reduction of uncertainty in the form of stable policy and decision-making frameworks, which AIGN disputes. This is an important element in encouraging investment in, and minimising costs imposed on, industry. It should be seen as a necessary element of an effective policy approach towards long-term emissions reductions.

Climate change policies should be considered in the context of their impacts on entity-level and national competitiveness. There are many factors that influence corporate decisions to invest in Australia, such as the tax regime, availability of skilled labour, and environmental policies. Policy impacts on investment decisions will differ across entities and sectors, depending on a wide variety of factors. It is not appropriate to infer that climate change policies are of limited relevance to investment decisions because other factors also apply; it is the interplay of the various factors and policies that will determine Australia's attractiveness (or otherwise) as an investment destination. For many of the industries represented by AIGN there are only limited technologies available to reduce emissions and they generally have high capital costs and technical risks. They present major technical and financial issues and highlight that the direct and indirect costs of policies to reduce Australia's emissions are of major importance.

It highlights that the Government should strive to minimise the detrimental impact of policy costs on investment decisions, work with industry to find ways to reduce emissions while encouraging environmentally and socially responsible investment, and engage in open conversations about the impacts of transitioning to a low-carbon economy, in a way that is conscious of the short-term costs associated with this transition and seeks to distribute these equitably.



3.1 International Competitiveness Issues

In the Terms of Reference for the Review, the Authority was asked to consider “*whether Australia should introduce an ETS that does not harm Australia’s business international competitiveness*”. Furthermore, in the Report itself, the CCA noted that it would be considering “*possible effects of emissions reduction policies on the international competitiveness of Australian businesses*”². This would be in the context of policy options that could potentially place Australian industry at a competitive disadvantage relative to other countries that do not face comparable obligations. Noting that the Paris Agreement was not concluded at the time of the Draft Report release, AIGN is still disappointed at the superficial analysis undertaken of the various INDCs submitted to the UNFCCC that are the best available measure of the policy approaches our competitors propose in respect of reducing emissions. A limited analysis would indicate that on the basis of the INDCs there will be significant differences in costs of carbon at the international level for the foreseeable future. AIGN makes further commentary on the INDCs and their implications for Australian climate change policy in the following sections.

With low tariffs and generally deregulated services, Australia’s economy is open to imports and investment in most industries. Most major Australian industries are trade-exposed. Australian industry competes with a diversity of countries across a range of key industries, including LNG (major competitors Qatar, Malaysia and Indonesia), aluminium (China, Russia, Canada and, increasingly, the economies of the Middle East), coal (Indonesia, South Africa, United States and Russia), and steel (China, Taiwan, South Korea, India and Japan).

3.2 An Assessment of the Implications of the Paris Agreement

AIGN welcomes the recent Paris Agreement and the commitment of the Parties to limit global warming to well below 2°C. However, AIGN further notes that the success of this latest international agreement will be dependent on the effective implementation of the agreed actions and commitments of individual Parties. As Professor Jeffrey Sachs of Columbia University noted following the conclusion of the Paris meeting: “*The diplomats have done their job: the Paris Agreement points the world in the right direction, and with sophistication and clarity. It does not, however, ensure implementation, which necessarily remains the domain of politicians, businessmen, scientists, engineers, and civil society*”.

Future Australian national policy approaches need to be undertaken in a considered manner, including a strong focus on trade competitiveness given the complexity and likely timeframe of the implementation of the key actions of the new international agreement. The significant variations in the levels of commitments and commencement dates of INDCs will be key factors in assessing relative national effort and potential Australian trade exposure.

² *Special Review – Second Draft Report: Australia’s Climate Policy Options*, Australian Government Climate Change Authority, November 2015, p.34.

3.3 Implications for Australian Climate Change Policies

From the perspective of transitioning to a lower carbon economy, the key test of the outcomes of the Paris Agreement relates to the encouragement it provides for industry and others to invest in long-term activities to reduce emissions and enhance carbon storage. This investment needs to occur in both developing and developed economies.

In the lead-up to the Paris negotiations, Australia made a commitment to reduce its emissions between 26% and 28% below 2005 levels by 2030. From an Australian industry perspective, and as a country with a large share of emissions-intensive production, resource and extractive industries, the incentive to invest will relate to how competitive Australia is as an investment destination. To avoid putting Australian industry at a competitive disadvantage, it will be important that the Paris Agreement heralds an environment of shared and comparable action, particularly with our major trade competitors.

Whilst the Paris Agreement removed past differentiations between developed and developing economies over responsibilities for reducing emissions, it cannot be adjudged an outright success until measures to ensure the integrity of INDCs are developed, implemented and followed, in such areas as measuring commitments, reporting arrangements and approaches to scaling-up ambition. It will also be critical for Australian industry that the agreement promotes the use of market-based mechanisms in reducing emissions, as this provides opportunities for minimising the costs of abatement.

A key issue for Australian climate change policy development will be a sound understanding of the Australian emissions targets and timetables that will be needed to contribute equitably to the twin UNFCCC goals of:

- a peaking of emissions as soon as possible (with a recognition that it will take longer for developing countries); and
- net greenhouse gas neutrality (expressed as “a balance between anthropogenic emissions by sources and removals by sinks”) in the second half of this century.

Equally important and complementary issues will be how these Australian targets and timetables might be achieved at least cost, and how implementation mechanisms might impact on (i) industry competitiveness, (ii) Australian economic development, and (iii) job availability, as well as Australian community welfare.

AIGN believes it will be a substantial and indispensable task to ensure that consultations and general community understanding of issues and options are soundly based. Basic analytical work will need to start in the near future in order to properly inform the important decisions needing to be made over the next couple of years.



3.4 Comparing Effort – Significant Differences across INDCs

Whilst many countries have brought forward INDCs, they differ greatly in levels of commitment, timeframes for action, and detail around proposed policy approaches.

AIGN's concern from a domestic policy perspective is that the Paris Agreement will be perceived as delivering a policy environment where all countries are taking similar and immediate action to reduce emissions and that the costs faced by industries are nearly identical across the international market. If this is the perception, then the risk is that the important issue of trade competitiveness could be downplayed, ultimately to the cost of Australian industry, as future policy measures are developed.

A realistic appraisal of the various INDCs indicates that major commitments to reduce emissions by many of our major trading competitors will not take effect for at least a decade or more, with China, India and the Middle East being prime examples.

Some brief commentary is provided below.

3.4.1 Disparate Policy Approaches

The various INDC responses highlight that no one likely policy approach will emerge on a global basis; rather, a patchwork of different national and regional schemes will evolve, impelled by a mixture of environmental and political influences. For example, whilst the European Union policy mix features an ETS in its approach to achieving its climate change objectives, the United States' approach is heavily weighted in favour of regulatory intervention.

It is also crucial to understand the potentially significant differences between the domestic policies that individual countries may choose to put in place to meet their targets. When looking at the 17 distinct ETSs already in force across four continents³, it becomes clear that no two schemes are the same; not just because targets may vary or some are sub-national, but also because of differences in legislative frameworks, implementation timetables, coverage of sources, coverage of sectors, treatment of emission-intensive trade-exposed (EITE) industries, exemptions and allowances, and robustness of monitoring, review and verification (MRV) practices.

3.4.2 Disparate Commitments

INDCs differ greatly in levels of commitment and how these commitments are to be measured. Not surprisingly, dates for comparison are often selected to show the Party in the best light in respect of its proposed emission reductions. For example, whilst many countries reference 2005 as the base year for comparison with future emission reductions commitments, both the EU and Russia select 1990 as the base year. In the case of Russia, there was a significant reduction in emissions following the collapse of the USSR post 1989, with the closure of a number of outdated and highly polluting industrial facilities. In the case of the EU, it was hard hit by the recession of 2008 and has also closed a number of major industrial facilities (relocated to China).

³ ICAP Status Report 2015.



Brazil has agreed to reduce emissions by 37% below 2005 levels (including LULUCF) by 2025. In contrast, Saudi Arabia has proposed an abatement in emissions of up to 130 MtCO₂e annually to 2030, which represents only a small tapering of its strong growth. Qatar and Iran have both experienced strong growth in emissions, with the latter being the eighth-largest global emitter, however, their INDCs provide no commitment to emissions reduction.

3.4.3 Realistic Comparison

An examination of various INDCs highlights that the existence of a national policy is not the end of the story, as the design of the policy is significant for determining the cost that a facility bears; other factors, such as coverage and the extent of exemptions, must be considered. In comparing climate change policies between countries, measurement of the differential economic effect of various policies is required. Carbon is such a ubiquitous input in most economies that mitigation policies will have economy-wide effects, extending well beyond the individual sectors that may have particular mitigation obligations.

The most appropriate measure of the level of effort of an emissions reduction target is the cost of climate policies to reach the target. Assessing the costs of a particular emission reduction target is complex. The minimum requirement in comparing effort between countries, and at the sector- and potentially entity-level, is to understand the true economic cost associated with the policies in place and resource flow. At the entity level, there can be interplay between what is expressed as a national policy on carbon, and the actual impact on an entity when all relevant policy measures are taken into account, as well as the impact upon other entities within the economy. Broad economy-wide comparisons are unlikely to be sufficient if different sectors face different effective carbon prices arising from different patterns of exemptions and offsets.

In reality, we are likely to see an environment where commitments outlined in INDCs are entered into at different stages. A good example is China. The commitments China has made are promising, but in reality they will not translate into measures approaching carbon pricing for another decade or so, and it is unclear how national policies may translate into activity at the regional level. Australia's experience highlights the lengthy process of moving from the commitment stage to taking action through to effective implementation, and indicates that major differences will remain in carbon costs between industries in different countries for some time.

Even when a policy covers a particular economic sector, the costs that entities within the sector are exposed to may not be the same as the headline costs of the policy. This is due to the practice of compensating, shielding or exempting EITE industries from part or all of a policy's costs. This is done in recognition of the inability of a domestic sector to influence the world price of goods and commodities, and the resulting competitive disadvantage of climate change policy costs in this context.

Trade competitiveness will continue to be an important issue until climate change policy costs become more common globally and begin to converge. The exemptions that apply to EITE industries vary considerably, from a minimum of 60% (up to 100%) for the proposed South African scheme, to 100% administrative allocation in the Korean scheme for the first 3 years. It is difficult to understand how current loose cap arrangements will translate into post-2020 policies or a target.

3.4.4 China

It is worth providing a specific comment on China's INDC, given it is the world's largest emitter. In its INDC, China committed to peaking carbon emissions around 2030, if possible, as well as reducing carbon intensity below 2005 levels by 2030. It also has policies in place to encourage renewables. China has committed to introducing a national ETS in 2017, and many Parties have treated this announcement as if it provides immediate coverage for all industries and all of the population.

Chinese Government representatives spoke at several side events in Paris on the transition from the existing seven trial ETSs currently underway, to a national scheme. It was emphasised several times that it will not be possible to extrapolate from these trials when developing a national approach, owing to the different approaches to key issues (for example, the legal framework – other than Beijing and Shenzhen, the other systems depend on local regulation and laws), cap structure and coverage, allocation and MRV rules. Due to the independent nature of the trial systems around the country, it would be unfeasible to gather and unify them. China has therefore declared that it will design a national system. Given the complexity of this process, it is unlikely that China will have a fully operating ETS within the next decade.

3.4.5 Impact on Australia

The above factors are not at all exhaustive in considering the variations in levels of commitment within INDCs. Whilst there will be encouragement for countries to lift ambition, past experiences under the UNFCCC process indicate a low likelihood of early action. It therefore implies that by 2020, the cost of carbon applying at the company level will differ greatly around the globe.

Sectors of the Australian economy that are likely to be the most adversely impacted from these international variations in the cost of carbon are those that are emission intensive and trade-exposed (with an inability to pass on increased costs to customers).

If Australian industry is not to be put at a competitive disadvantage through the imposition of costs that do not apply to our international competitors, policies should be introduced that offset the differences in carbon costs between trade-exposed Australian entities and their major competitors. Comparisons should be at the facility level in both Australia and competing jurisdictions.



4. Conclusion

If Australia (with high levels of trade exposure and a large share of emissions-intensive production, resource and extractive sectors) raises the cost of production at a higher rate than other countries (especially our trade competitors), it will put itself at a relative disadvantage and reduce the economic welfare of Australian citizens for no appreciable change in the global level of emissions. Any such impact would be detrimental to trade-exposed industries in Australia, particularly in the absence of adequate compensatory measures. This has been recognised in Australia under past policy frameworks with the provision of specific arrangements for affected industries.

A key issue going forward will be ensuring that actions match commitments. The Paris Agreement does not include any sanctions for failure to achieve targets, nor has a transparency framework been established (although AIGN does acknowledge the inherent difficulties in a top-down, legally binding approach to international climate agreements, which has led to this situation). Australia should focus its efforts on accountability arrangements that will apply into the future, as well as encouraging an upscaling of the levels of commitment through rigorous and transparent reporting/review measures. It will also be important to have significant involvement in issues around market mechanisms and the future of the Clean Development Mechanism and other market measures, given the opportunities they may provide for least-cost abatement.

From an Australian policy perspective, issues around trade competitiveness will remain relevant in considering future policy approaches if Australian industry is not to be put at a competitive disadvantage through the imposition of costs that do not apply to our competitors. It would be a major policy turnaround to introduce policies that do not account for the differences in carbon costs between trade-exposed Australian entities and their major competitors. Such policies should apply as long as differences in policy, and hence carbon costs, apply.



Attachment 1. AIGN Policy Principles

The Australian Industry Greenhouse Network's position on climate change is informed by the following principles.

Australia should make an equitable contribution, in accordance with its differentiated responsibilities and respective capability, to global action to reduce greenhouse gas emissions and to adapt to impacts of climate change. Further, Australia should engage the international community in pursuing identified and beneficial environmental outcomes through greenhouse gas emissions reduction action that:

- allows for differentiated national approaches;
- promotes international cooperation;
- minimises the costs and distributes the burden equitably across the international community;
- is comprehensive in its coverage of countries, greenhouse gases, sources and sinks;
- recognises the economic circumstances, social circumstances and aspirations of all societies; and
- is underpinned by streamlined, efficient and effective administrative, reporting and compliance arrangements.

In this global context, Australia should develop a strategic national approach to responding to climate change that:

- is consistent with the principles of sustainable development;
- is consistent with other national policies, including economic growth, population growth, international trade, energy supply and demand, and environmental and social responsibility;
- takes a long-term perspective;
- maintains the competitiveness of Australian export- and import-competing industries;
- distributes the cost-burden equitably across the community;
- adopts a consultative approach to the development of new policies; and
- is consistent and effectively coordinated across all jurisdictions throughout Australia.



Australia's future greenhouse policy measures should:

- be consistent with the strategic national approach;
- be trade- and investment-neutral, in a way that does not expose Australian industry to costs its competitors do not face;
- not discriminate against new entrants to Australian industry nor disadvantage 'early movers' in Australian industry who have previously implemented greenhouse gas abatement measures;
- take account of differing sectoral circumstances;
- be based as far as is practicable on market measures;
- address all greenhouse gases;
- address all emission sources and sinks; and
- balance, in a cost-effective way, abatement and adaptation strategies, both of which should be based on sound science and risk management;

Australia's contribution to the global climate change effort as set out here reflects the principle in Article 3.1 of the United Nations Framework Convention on Climate Change. Differentiated responsibilities and respective capabilities could take account of such matters as a country's economic growth and structure, population growth, energy production and use etc.