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RESPONSE TO
“POSSIBLE DESIGN FOR A NATIONAL GREENHOUSE GAS EMISSIONS TRADING
SCHEME”

SUMMARY

A3P acknowledges the substantial amount of work that has gone into preparing *Possible Design for a National Greenhouse Gas Emissions Trading Scheme* in a short timeframe. There are many elements of the proposed scheme design that provide the certainty, market signals and investment support that the plantation products and paper industry would like to see in a market response to climate change

If a national emissions trading scheme is implemented it is vital that a range of other Government energy efficiency, energy reporting and greenhouse reporting programs be removed.

The explicit inclusion of forestry offsets and measures to address the competitiveness of energy-intensive, trade-exposed industries in the scheme design are welcome.

Forest Offsets

The following changes are recommended to the proposed treatment of forest offsets.

1. ‘Credit’ should be given for the carbon retained in wood products while in use and after disposal by using standard emission or decay factors for timber products.
2. Substitution of forest credits with any form of abatement should be allowed, to improve the efficiency of managing carbon pools over time.
3. Carbon sequestered in plantations/wood products should be allowed to be sold at any time after it is first sequestered.
4. Plantation managers should receive credit for the average of their carbon stocks over a 100-year time frame rather than the minimum.

Energy-intensive, trade-exposed industries

A3P expects that the proposed treatment of energy-intensive, trade-exposed industries will achieve the following:

- simple, streamlined processes
- stable treatment of companies, facilities and products

- durable rules and procedures
- detailed, unambiguous criteria and rules that prescribe how decisions will be made
- decision-making that is rigorous and fact-based
- decision-making and regulation through a body that has authority to make determinations but is clearly separated from Government and political influence

The possibility that the proposed design may breach the WTO makes it vital to get thorough advice from experts before developing this part of the scheme design further.

The assessment of energy-intensity and trade exposure should be done at a facility (plant) level due to the many variations in product, process, markets, price and international competition.

The 'long-term enforceable promises on permit allocation' must take the form of a legally enforceable, compensable property right.

An assessment of whether fair international competition existed would need to be undertaken separately for each product and consider countries that play a significant role in setting international benchmark prices as well as countries that compete with Australian production in domestic or export markets.

To prevent perverse incentives for reducing Australian production of pulp it is proposed that the production of pulp be treated as one industry and the production of paper (from pulp) as a separate industry, even if the two processes are sometimes combined on a single site.

BACKGROUND ON A3P

A3P is the national representative body for the Australian 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.

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, Indonesia and Brazil. 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 2003-04 with more than 12 000 TJ produced from renewable sources on-site.

The *solid wood sector* is an energy user and a potential producer of renewable energy. Sawntimber stores carbon and has a significantly lower global warming potential than competing building materials.

The *plantation growing sector* manages significant carbon sinks. Activity in this sector 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.

CLIMATE CHANGE AND EMISSIONS TRADING

A3P acknowledges that human activities have had an impact on CO2 levels and this is leading to a change in global climate. A swift and meaningful global response is required. Market forces are efficient and powerful in addressing an issue of this magnitude and timeframe.

Our preference is for a global response that does not distort market competitiveness and captures all greenhouse gases, types of sources and locations. Given that this is unlikely in the medium term and some form of second-best policy measure will be implemented, A3P supports market responses that:

- minimise the cost of action.
- are clear, simple and not obstructed by conflicting Government programs
- provide long-term secure property rights
- acknowledge the benefits of carbon stored in plantations and wood-based products
- acknowledge the benefits of renewable energy production
- address the potential loss of competitiveness for energy-intensive, trade exposed industries

GENERAL RESPONSE

A3P acknowledges the substantial amount of work that has gone into preparing *Possible Design for a National Greenhouse Gas Emissions Trading Scheme* in a short timeframe. Particular credit is due for the effort to understand the impacts on industry of emissions trading and to design a scheme that aims to address these impacts while maintaining incentives for reductions in greenhouse gas emissions.

The Discussion Paper acknowledges the need for investment certainty and canvasses the possibility that permits could be allocated to the lower limit of the cap 'gateway', up to 20 years in advance. Certainty over a twenty year timeframe is obviously superior to shorter periods, however the lives of investments in plantations (30-40 years) and pulp & paper mills exceed twenty years and the proposed model will still introduce elements of uncertainty and risk in investment decisions.

The proposed distribution of permits, to generators and trade-exposed energy-intensive industries, to offset inequities created by the scheme is also welcome. The loss of international competitiveness has been the greatest concern of the pulp & paper industry regarding the introduction of a carbon cost. More comments on this aspect of the proposed design are provided later in this submission.

The explicit inclusion of forestry offsets, based on the model developed for the NSW GGAS scheme, provides the opportunity for the plantation industry to leverage carbon funding into resource expansion, thereby providing a range of environmental benefits. Forestry offsets will form part of a range of abatement opportunities that will allow the market to find the least cost path to emissions reductions.

COVERAGE AND COST

Emissions trading is promulgated as an appropriate policy response to climate change because of its ability to find least cost solutions without requiring Governments or regulators to pick winners. The extent to which this is achieved depends on the design of the scheme. Two critical factors are the coverage and cost.

A3P is disappointed that the proposed design is restricted initially to the electricity sector (33% of total emissions, page34) and then to the stationary energy sector (in aggregate 45% of total

emissions). While the inclusion of offsets will enable non-covered sectors to participate, the proposed design has not succeeded in placing emissions reduction incentives in the business decision-making of the agriculture and transport sectors – two major sources of emissions in Australia. A3P would like to see proposals for early incorporation of more emission sources, increasing the efficiency and lowering the cost of abatement

The cost of administering and participating in the scheme is essentially money that could otherwise have been spent on emissions reductions by either government or private enterprise that has been 'lost'. It will be imperative during detailed design of the scheme that the appropriate desire to maintain integrity of the scheme and fair treatment does not lead to disproportionate increases in the cost of administration or participation.

OTHER GOVERNMENT ENERGY AND GREENHOUSE PROGRAMS

As noted above, the strength of emissions trading is that it allows the market freedom to find the lowest cost solution. There are a range of Government energy efficiency, energy reporting and greenhouse reporting programs that have been implemented because a greenhouse market signal has not been present in the Australian economy.

If a national emissions trading scheme is implemented it is vital that these other programs be removed. The programs fall into two categories – those that encourage a particular type of abatement and those that require reporting and transparency.

If an emissions trading scheme is in place, a separate program that subsidises particular types of abatement opportunities will skew the market and inevitably lead to a greater cost for the same abatement outcome.

It will be argued by parties who benefit that there are reasons for these programs to be retained. These might include the need to develop or commercialise technological development, or other benefits of the particular technology. If these needs or benefits are real they should be managed by programs that explicitly address the issue in a manner that limits distortions to an emissions trading market.

Programs that encourage or require reporting and transparency have been implemented to raise public awareness and encourage cultural changes within private enterprise. It would be difficult to see any justification for these schemes once an emissions trading scheme is in place.

It should be noted that there are two types of policies with a greenhouse emphasis that do not distort the operation of the market and are vital to long term reductions in greenhouse gas emissions: support for research & development of new technology, and policies in sectors not covered by an emissions trading scheme.

Previous submissions from A3P and other industry groups have made the point that a carbon price alone, while effective in deploying currently available technology, is not sufficient to bring forward the next generation of low-emission technology. More focused research & development assistance is needed to achieve this.

Given that the proposed emissions trading scheme does not cover a large proportion of Australia's greenhouse gas emissions there is justification for targeted programs within non-covered sectors.

OFFSETS

A3P supports the proposal in the discussion paper to include offsets within the scheme design. As noted, this will help minimise the cost of abatement and allow opportunities in non-covered sectors to be included in the scheme. The explicit inclusion of forestry offsets is clearly of interest and benefit to our industry and consistent with the Kyoto Protocol.

Additionality

The proposed approach of requiring a project to demonstrate reductions beyond a plausible baseline and to meet specific project eligibility tests, including the regulatory and legal requirements of the relevant jurisdiction, is supported. The regulatory and legal requirements of interest should be those that applied at the time the project was implemented to remove any risk that a project could lose its eligible status at a later date. A3P agrees that a test for financial additionality would not be efficient or practical.

Baseline setting

The discussion paper proposes a combination of top-down and bottom-up approaches for baseline setting. This seems to be an appropriate path forward. It also seems logical that offsets through afforestation and reforestation would be suitable as a priority sector for clear and prescriptive rules.

They may also be other offset opportunities within the plantation products and paper industry that are suitable for a bottom-up approach where the project proponent comes forward with their own baseline.

Transaction costs and institutional arrangements

A3P strongly agrees with the proposal that liability for compliance rest with the seller. A buyer liability approach would reduce offsets to an inferior product in the eyes of a purchaser and reduce their value or inhibit the establishment of an effective market.

Limitations and caps

The issue of whether caps should be applied to the proportion of a liable parties' obligation that could be met by offsets or by particular types of offsets (CDM, forests, etc) is raised in the discussion paper. The justification often put forward for limitations is to ensure that the necessary fundamental changes to meet long term targets occur in the economy.

However, achieving changes in the economy at the pace necessary to meet long term targets is best done through the setting of shorter term targets. The environment is blind to the type of abatement that is undertaken and placing limitations on certain activities works against one of the key objectives of an emissions trading scheme: achieving greenhouse gas emission reductions at least cost.

FOREST OFFSETS

The inclusion of forest projects as offsets under the proposed emissions trading scheme is clearly of interest and benefit to the plantation products and paper industry. The use of the framework currently operating under NSW GGAS is an appropriate starting point as many of the issues have been dealt with during its development.

The discussion paper invites comment on how the approach should be adjusted or enhanced under a national emissions trading scheme. The current accounting approach under GGAS makes it difficult for a commercial plantation grower (i.e, a grower that is harvesting and re-establishing the plantations) to access 'credit' for the full benefit that is being provided.

Rather than being attributable to any single factor, this has resulted from the interaction of a number of rules and approaches including:

- the assumption that all carbon is emitted at the time of harvesting
- the requirement to demonstrate 100-year permanence of the forest
- the requirement to make good any shortfall with other forest credits rather than any form of abatement.
- limitations on averaging

Managing a commercial plantation estate leads to sequestration of carbon in the trees. At the time of harvest much of this carbon is potentially freed and will be released back to the environment over time as material decomposes. However the carbon retained in the wood products remains sequestered for as long as the product is in use and for many decades after disposal. At the same time, the plantation is re-established and a subsequent process of sequestering carbon commences.

While the carbon stocks on the plantation site rise and fall between relatively constant maxima and minima, the increase in wood products in use and in landfill represent a real increase in sequestered carbon over time. The current accounting rules acknowledge the increases and decreases on site but do not acknowledge the steady increase in wood products in use and in landfill.

Addressing this discrepancy is warranted but A3P understands the concerns over maintaining integrity and consistency within the scheme. Accordingly the following changes are recommended to the GGAS framework for use within a national emissions trading scheme, without precluding further amendments as more data becomes available and international carbon accounting conventions evolve.

1. 'Credit' should be given for the carbon retained in long-term wood products while in use and after disposal by using standard emission or decay factors for timber products.
2. Substitution of forest credits with any form of abatement should be allowed, to improve the efficiency of managing carbon pools over time.
3. Carbon sequestered in plantations/wood products should be allowed to be sold at any time after it is first sequestered.
4. Plantation managers should receive credit for the average of their carbon stocks over a 100-year time frame rather than the minimum. This is equivalent to pooling and would reflect genuine equivalence with the global warming impact.

Objective

The objective of the accounting framework for forest offsets should be to accurately reflect the true fate of carbon, giving credit for sequestration and liability for emissions as and when they occur.

Consistency with international rules and minimising the cost of transactions are also considerations but they should be used to modify rather than supplant the main objective.

Baselines and additionality

The GGAS approach of 'zero baseline' for afforestation and reforestation is administratively practical and reflects the reality that there is no reason to believe that significant levels of new plantation establishment would be occurring as part of 'business as usual'.

Uncertainty

The current GGAS framework requires that there is at least a 70% probability that the actual carbon stock change is equal to or exceeds the estimated carbon stock change. This is currently met by project proponents through uncertainty analysis. However, this presents a barrier for smaller growers.

A3P recommends that an option be created to account for carbon using a standard tool (such as the National Carbon Accounting Toolbox), to which a standard adjustment factor could be applied in lieu of undertaking uncertainty analysis. This would need to be constructed in a way that maintains the incentive and reward for growers to undertake their own uncertainty analysis should they opt to.

ENERGY-INTENSIVE TRADE-EXPOSED INDUSTRIES

Imposing a carbon cost in Australia when a similar cost is not being imposed on competing facilities that operate in other countries would reduce the competitiveness of energy-intensive trade-exposed industries. The discussion paper proposes to address this potential loss of competitiveness by allocating permits to these industries to offset the estimated increase in energy prices.

The allocation of permits would be done annually, linked to output levels, but within a framework of 'long-term enforceable promises'. From 2020, the allocation would be based on product-specific benchmarks that reflect Australian best practice energy intensity. Similarly, new entrants would be eligible for free permit allocation based on best practice energy intensity using commercially viable technology.

Permit allocation to energy-intensive trade-exposed industries would cease when competing nations are subject to a similar carbon constraint.

The proposed design is based on a sound understanding of the potential negative impacts on energy-intensive, trade-exposed industry. It proposes measures that could mitigate the loss of competitiveness.

To provide the necessary therapeutic effect for energy-intensive, trade-exposed industry, the measures must be robust, free from political interference, durable, fair and efficient. Until greater detail has been developed, it is not possible to fairly assess the effectiveness of the proposed measures. We acknowledge the willingness of the National Emissions Trading Taskforce to develop this detail and would welcome the opportunity to participate.

Of particular interest is the treatment of, or decisions relating to:

- the criteria for determining energy-intensive, trade-exposed industries
- the level at which energy-intensity, trade-exposure will be assessed (product, process, facility, company, industry)
- estimates of increases in electricity prices
- estimates of future permit prices
- the enforceability of the promise of future permits
- 'benchmarks of Australian best practice energy intensity' for post 2020
- 'best practice energy intensity using commercially viable technology' for new entrants
- determining if and when fair international competition exists
- compliance with WTO and the process if the scheme is found to be non-compliant

Until there is further detail available it is not possible to determine if the proposed treatment of energy-intensive, trade-exposed industries will be effective in maintaining their international competitiveness. Of interest to A3P is the extent that the treatment of these matters will achieve the following:

- simple, streamlined processes that do not require the preparation of expensive submissions, or lengthy negotiations or disputes
- stable treatment of companies, facilities and products so that once the level of permit allocation has been determined it can proceed routinely in future years
- durable rules and procedures so there is no risk that a company's entitlement will be reduced in future through decisions that whittle it away or wipe it out entirely (other than in the ways explicitly proposed in the scheme design)
- detailed, unambiguous criteria and rules that prescribe how decisions will be made and enable companies to make reasonable estimates of permit allocation

- decision-making that is rigorous and fact-based and not subject to excessive or vague interpretation
- decision-making and regulation through a body that has authority to make determinations but is clearly separated from Government and political influence

While not precluding consideration of other alternatives, A3P makes the following observations on the possible treatment of energy-intensive, trade-exposed industries:

Compliance with WTO

The possibility that permit allocation to energy-intensive, trade-exposed industry, particularly to new entrants, could be deemed non-compliant with the WTO is a significant concern. A3P does not have expertise in this area and hence puts no view forward here. However it would not be worthwhile developing this part of the scheme design further without receiving thorough advice from experts. At best it would help guide the design of the permit allocation procedure to ensure it was compliant and at worst it would demonstrate that an alternative method to address international competitiveness is needed.

Criteria for energy-intensive, trade-exposed

A3P is broadly in agreement with proposed criteria (p132). It should be noted that given the large modelled increases in energy prices presented in the discussion paper, a relatively low threshold for energy-intensity should be applied. If energy represents even a few percent of costs, an emissions trading scheme may still have a material effect on production costs.

The assessment of the level of international competition should include more than a simple analysis of imports and exports. In many cases, particularly where there are a small number of suppliers or purchasers, prices may be set in reference to international benchmarks even though imports are low. This reflects the opportunity that exists for the purchaser to buy from overseas suppliers even if that option is not exercised presently.

Level of assessment

The assessment of energy-intensity and trade exposure could only practically be done at a facility (plant) level due to the many variations in product, process, markets, price and international competition. This will make the administrative and regulatory task greater but to undertake the assessment at a higher level of aggregation will create too many unintended winners and losers from permit allocation.

Future permits

The exact form of 'long-term enforceable promises on permit allocation' is of great interest. This must take the form of a legally enforceable, compensable property right. A promise that is vulnerable to changes in Government policy without compensation would undermine the investment certainty that the scheme design is rightly looking to establish.

Post 2020 benchmarks of energy intensity

The reasoning behind using best practice energy intensity benchmarks after 2020 to maintain incentives for emissions reductions is understood. However, the ability of an existing facility to attain Australian best practice will be heavily dependent on the age of the facility. It may not be possible, other than through complete rebuilding to bring a forty year old facility to Australian best practice.

The Taskforce's response to this may be that creating an incentive to close existing facilities and rebuild with new technology is consistent with the objective of the proposed scheme. However, it should be understood that the companies operating in the pulp & paper industry are global and that capacity closed (prematurely) in Australia has a high likelihood of being replaced with capacity elsewhere in the world.

Fair international competition

An assessment of whether fair international competition existed would need to be undertaken separately for each product. Attention should be paid not just to those countries that compete

with Australian production in domestic or export markets but also countries that play a significant role in setting international benchmark prices.

Intermediate products

There is a specific issue relating to the energy intensity of the production of paper that warrants further consideration, though there are probably analogous situations in other industries.

The production of paper includes two distinct stages: pulping and papermaking. Of these, pulping is the more energy-intensive stage. There is the potential that some of the pulp produced at a mill may be sold to another paper mill and similarly some of a paper mill's pulp requirements will be purchased from external sources (including imports).

The apparent greenhouse gas emissions profile of a mill's paper production could be greatly reduced by purchasing pulp from elsewhere, or conversely, would be greatly increased if imports of pulp were replaced by on-site pulping. In both cases, the allocation of permits would create a perverse incentive to reduce Australia's pulp manufacturing levels.

It would seem possible to address this issue by treating the production of pulp as one industry and the production of paper (from pulp) as a separate industry, even if the two processes are sometimes combined on a single site. However this may mask possible incentives for changes in pulp mix that would produce real reductions in greenhouse gas emissions.

This submission has not attempted to address all the questions raised in the discussion paper but has focussed on the more important design elements from the perspective of the plantation products and paper industry.

Thank you for the opportunity to provide input on the Consultation Paper. 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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