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## DRAFT REPORT ON AUSTRALIA'S CLIMATE POLICY OPTIONS

Thank you for the opportunity to make a submission on the Climate Change Authority's *Draft report on Australia's climate policy options*. This submission is made on behalf of the bauxite mining, alumina refining, and aluminium smelting sectors, which directly employ more than 14,000 people and sustain the livelihoods of more than 50,000 households, most in regional Australia. We are responsible for more than $9 billion of export earnings for the Australian economy and make up a substantial part of the economic activity in regions where we operate, including Arnhem Land, Gladstone, south-west Western Australia, Hunter Valley, Cape York, Portland and Tasmania.

Our submission is provided in two parts – a response to some statements in the Authority's draft report; and answers to some of the specific questions posed. Both parts focus on Chapter 5 of the draft report: *Addressing international competitiveness concerns.*

### RESPONSE TO STATEMENTS IN THE DRAFT REPORT

A number of statements in the draft report propose, or imply, a particular model of 'best policy'. We have quoted the statements from the report below along with some comments to suggest, or ensure, a broader view on the issues.

#### Distribution of costs

> Where policies are designed to minimise costs for some firms (for example, in emissions-intensive trade-exposed sectors), they may increase costs for other firms, and for the broader Australian economy. Policy design therefore needs to consider the benefits and costs of measures to address competitiveness concerns.

There is little argument that policy design controls the distribution of costs. However, it should not be implied that any policy element that shifts costs between stakeholders is therefore negative, or moves policy away from the optimum. The policy objective is a 'public good' and there are compelling reasons to believe that - without measures to rectify it – the costs will fall disproportionately on businesses who have invested in emissions-intensive trade-exposed sectors, as well as employees of those businesses, and the communities in which they live.

Policy design should be seeking to achieve an equitable distribution of the costs, not simply assessing the costs and benefits of measures that change the cost distribution from its 'raw' state – such as measures to address competitiveness concerns.

Policy certainty

> Where emissions reduction policies increase costs for firms (for example, through higher energy costs, or higher taxes), they may make new investment in Australia less attractive. On the other hand, policy uncertainty and instability increases risks for investors, and can hamper Australia's competitiveness.

The statement above implies there is a trade-off, or choice, between imposing costs on businesses through emissions reduction policies; and imposing costs through policy uncertainty. There is, clearly, a third possibility – namely a certain and stable policy that minimises costs imposed on firms. While certainty is desirable (and essential in the longer run), it should complement, not replace, the need for well-designed policy.

Factors shaping competitiveness

> In practice, firm- and national-level competitiveness is a function of multiple factors… national competitiveness is likely to be driven by structural factors such as the broad business environment, education and the availability of skilled labour, labour market regulation, innovative capacity and institutional quality (Arlinghaus 2015; PMR 2015). Industry location is also influenced by access to resources and the quality of infrastructure.

It is flippant to dismiss the impact of one factor – emissions reduction policies – on competitiveness, because of the existence of other factors. By that false logic, all factors could individually be dismissed (because of the existence of the others) and competitiveness completely ignored.

In reality a business must carefully manage, and seek to improve, all factors that impact competitiveness. It will be the balance of those factors – and the business's ability to use its strengths and minimise its weaknesses – that will govern success. With so many of the factors beyond the business's control and working to the disadvantage of Australian businesses, the Government can ill afford to make the task of competing even harder through poorly designed emissions reduction policies.

Carbon leakage

> However, countries representing more than 90 per cent of global emissions and population have made emissions reduction pledges in the lead up to the Paris conference, and the vast majority of these involve specific economy-wide targets… Such broad international commitment to climate action greatly reduces the risk of carbon leakage.

We understand the logic behind the statement above to be: if most countries have effectively capped their emissions then any increase in emissions from the movement (leakage) within an industry sector would have to be compensated by reductions (compared to the counterfactual) in other sectors and therefore overall emissions would not increase.

This section of the draft report glosses over the impact on competitiveness of the messy and inconsistent detail in global climate action, including:

- Differences in the structure of countries' emissions reduction pledges – most obviously the difference between absolute targets and intensity targets, or between historical year benchmarks and business-as-usual;
- Differences in the severity of the constraint imposed by the country's target;
- Differences in rigour in monitoring and enforcement; and
- Cumulative impact of the countries that are not part of the "most" who have made pledges, take their targets seriously, implement policies and will meet their future goals.

These factors create sufficiently uneven sets of constraints and costs that carbon leakage remains a live prospect.

In the aluminium industry, the major global competitors include China, the Middle East, Brazil, Indonesia and Malaysia. It is difficult to sustain an argument that the emissions reduction pledges of those countries are sufficiently similar to conclude that there "is a low risk of carbon leakage".

**ANSWERS TO SPECIFIC QUESTIONS**

Chapter 5 of the draft report poses four specific questions around international competitiveness. We have provided answers to these below.

Q.14. Which international competitiveness impacts are most important to designing Australia's climate policy toolkit, and why?

International competitiveness plays out at a facility level (for existing facilities and potential new investments). In a largely commoditised market such as the aluminium industry, firms compete on the basis of costs of production. It is the actual increase in costs – both direct and indirect - experienced by an Australian facility from climate policy, relative to its international competitors, that will impact decisions about ongoing operation and investment.

Australian climate policy therefore needs to consider the actual cost increases experienced by facilities in competing jurisdictions. We note that one of the terms of reference for the special review is "whether Australia should introduce an ETS that does not harm Australian businesses internal competitiveness". This requires consideration beyond national level pledges and policies. Factors such as: timing of policy implementation; mitigating measures; sub-national policies and measures; and enforcement, must all be considered as they determine the extent of cost imposed on competing producers.

Previous studies of Chinese carbon costs and international carbon costs in the aluminium industry (previously shared with the Authority) revealed that the impact at a facility level may be greatly different (and usually lower) than initially apparent from the national policy.

Q.15. What is the current risk of carbon leakage, in light of the Paris climate conference and associated national commitments?

The previous studies of global carbon costs in the aluminium industry, noted above, demonstrated that differences in carbon costs were sufficient to impact or change decisions around continued operation of, and investment in, facilities. This is particularly so given the industry has been characterised for a number of years by narrow (or non-existent) margins and a flat global cost curve (i.e. small changes in costs will significantly impact cost ranking).

While the Paris climate conference has prompted significant progress at a global and national level – particularly the number of countries making pledges – there will still be material differences in carbon costs for many years (decades). The existence of pledges for the majority of countries does not remove the risk of carbon leakage, as earlier explained.

Global action is sufficiently uneven, and carbon costs sufficiently material, that the risk of carbon leakage in the aluminium industry remains high.

Q.16. Which sectors are most likely to face adverse impacts on their international competitiveness from climate policy and why?

The numerous previous reports that have explored climate policy design issues have consistently concluded that the sectors most likely to face adverse impacts on international competitiveness are characterised by:

- Emissions-intensity – the higher the emissions-intensity (measured on a denominator such as costs, value or added-value) the higher the relative cost imposed by a price on emissions.

- An inability to pass on increased costs to customers – often measured by trade exposure as it indicates that facilities are price-takers in a global context.

- Differences in carbon costs between the jurisdictions most significant for production, trade and/or investment.

These characteristics remain the most important.

Q.17. How do you think these impacts should be addressed?

These impacts should be addressed by a clear, simple, predictable measure that nullifies the loss of competitiveness from the domestic carbon policy for trade-exposed industry. Important features of this measure include:

- It should be linked to the differences in carbon costs that exist between Australian facilities and major competitors;

- It should endure for as long as the differences in carbon costs remain;

- Any consideration of comparative carbon costs, must look at the actual costs imposed at a facility level in Australia and in competing jurisdictions;

- It should fully offset the differences in carbon cost that might otherwise exist; and

- It should be linked to levels of production to enable expansion of Australian facilities where competitive and avoid creating an incentive for closure.

**INTERNATIONAL COMPETITIVENESS IN THE ALUMINIUM INDUSTRY**

The situation can be illustrated by examining the two major competitors to Australia in the aluminium industry:

- China – which has been responsible for the majority of global growth in both alumina and aluminium production and is now the largest producer of both;

- the Middle East – the location of most recent non-Chinese investment and the benchmark for lowest cost production of both alumina and aluminium.

China's alumina and aluminium production is predominantly in the northern and western provinces – far removed from the pilot emissions trading schemes. The facilities are within designated economic zones within China. The Chinese Government has an explicit intent to

develop industries, infrastructure and employment in these areas, even while it tries to reduce pollution and constrain industry in the eastern provinces. Many Government policies that apply elsewhere are not applied in these areas. Even if China implements a 'national' emissions trading scheme, it is highly unlikely that it will impose a cost on major recent investments in these provinces.

The countries in the Middle East have made little in the way of meaningful commitments to constrain greenhouse gas emissions and there are unlikely to be any carbon constraints or costs imposed on industrial facilities in these countries for the foreseeable future.

Australian alumina refineries and aluminium smelters compete directly for markets and investment with facilities in these jurisdictions that are unlikely to face carbon costs for many years. In the case of aluminium smelters, an increase in costs on Australian facilities may move them up the global cost curve to the point where they will be (further) exposed to the risk of closure. In the case of alumina refineries, it would also, perversely, increase costs for, and reduce investment in, facilities that have amongst the lowest greenhouse gas footprint in the world.

These competitiveness concerns should, and can, be addressed in the design of Australian climate policy.

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Thank you for the opportunity to comment on the Authority's *Draft report on Australia's climate policy options*. We welcome the opportunity to provide further briefing on these matters if desired. If there are any questions please contact me on 0429 923 605 or at miles.prosser@aluminium.org.au.

Yours sincerely

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