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Emissions Reduction Fund submissions
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DRAFT SAFEGUARD MECHANISM RULE 2015 – ALUMINIUM COUNCIL RESPONSE

Thank you for the opportunity to make a submission (see Appendix) on the Draft National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015. 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.

With direct emissions of 18.5 million tonnes CO₂-e per year and indirect emissions of more than 25 million tonnes CO₂-e per year, the safeguard mechanism will have a significant impact on our sector - hence our interest in the design of this policy.

The Australian Aluminium Council (AAC) believes that any policy approach to climate change should not harm the competitiveness of Australian businesses and industry – this intent had been affirmed by the Government in earlier stages of emissions reduction policy development.

However, we are concerned that the proposed safeguard mechanism rules do not deliver on this intention.

The AAC submission highlights key issues and concerns with the rules proposed, including:

- The absolute emissions baseline is of limited relevance to our facilities, as production needs to steadily increase every year to stay internationally competitive. We have continually advocated for an emissions-intensity metric to alleviate this issue - this has only been partially included;
- The intensity metric in its current form requires year-on-year improvement in intensity – this is unrealistic in the face of normal variability and will likely punish the facilities already operating efficiently (Australia already has some of the best facilities in the world for direct carbon emissions intensity, achieving this through years of early action); and

- Many Australian facilities that will face costs due to the safeguard mechanism operate at approximately 1/3 of the carbon intensity of some competitors in Asia who will pay no carbon price – this seems like a perverse outcome, where a number of the world's and Australia's best and most efficient facilities are harmed by emissions reduction policy.

The rules should be redrafted to address these problems. Our proposed option is to *not reset the emissions-intensity baseline each time the variation in baseline determination is applied, but maintain the emissions-intensity baseline from the same year as the initial determination.*

We indicate our strong interest in being consulted on any other changes that occur through the parliamentary process. The safeguard mechanism rules have the potential to significantly impact Australia's facilities, which are valuable assets to the Australian economy and are already operating in a competitive international market.

Thank you for the opportunity to comment on the Draft National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015. 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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Original Intent of the Safeguard Mechanism

The imposition of costs by the safeguard mechanism on rational business decisions – as would occur under the proposed rules – is at odds with initial statements of the policy, which was not to punish ‘business as usual’ levels of production in order to avoid harming Australia’s production economy. These statements were reiterated at each stages of development of the policy surrounding the safeguard mechanism. For example, the Coalition’s Direct Action policy statement prior to the election stated clearly: “this will be achieved without new or increased taxes on Australian industries or increased costs to Australian households and families. We are committed to incentives rather than penalties; to rewarding positive action rather than punishing Australian families, households and businesses,” and: “rather than punishing industry for production and employment, Australia needs a scheme that will provide the incentive for firms to reduce their carbon emissions and, at the same time, minimise the costs to industry and the Australian economy. It is vital that any approach to climate change does not hurt the competitiveness of Australian businesses and industry.”

This was reiterated with the release of the Green Paper, which claimed the policy would “allow businesses to continue ordinary operations without penalty”.

The subsequent White Paper then provided further detail by suggesting that “flexibility could be provided where a business’ emissions rise above absolute baselines, but that business can demonstrate that its emissions intensity of production is not rising”.

The purpose of the safeguard mechanism has repeatedly been described as to “ensure that emissions reductions purchased by the Government are not offset by significant increases in emissions above business-as-usual levels elsewhere in the economy” [emphasis added]

The proposed rules for the safeguard mechanism including the emissions intensity test do not deliver on these statements, as outlined below.

Our Operations - Business as Usual (Absolute Emissions & Emissions Intensity)

Australia’s aluminium smelters and alumina refineries operate in highly competitive and openly traded global markets, with expected demand growth of up to 7% per annum. In this context, all facilities, particularly the best quality assets, continually seek to increase production by at least 1-2% per annum. This growth is likely to also incrementally increase absolute emissions, as well as see fluctuations in emissions intensity (although the latter is expected to gradually decrease over time). Increasing production is a rational business decision that maintains the viability of facilities in a competitive international market and benefits the Australian economy in numerous ways.

The production increases (described as ‘production creep’) can come from a range of factors, including efficiency improvements, improved work practices, debottlenecking, utilising spare capacity, and process improvements. Often, increases in production do not require significant capital investment.

The Government's policy had "twin objectives": to reduce greenhouse gas emissions while sustaining economic growth. Sustained incremental increases in production, particularly in the most productive and efficient facilities, are the principal means by which the processing and manufacturing sectors of the Australian economy can deliver on these twin objectives – growing production in efficient Australian facilities and out-competing facilities with higher emissions in other countries. Yet the rules for the safeguard mechanism propose to impose a cost on those incremental expansions.

Incremental expansion in production will breach historical absolute emissions baselines. Production is likely to be higher than the previous five-year high point, and would be expected to continue to grow. As a result, absolute emissions will also be expected to be higher than an historical five-year high point.

Emissions intensity will fluctuate between years due to a range of factors – including variations in the characteristics of key inputs and the intermittent and random nature of process interruptions.

Even the best-managed facilities will experience variances in emissions intensity of a few percent from year to year that would trigger financial penalties under the proposed requirement for improvements in emissions-intensity every time the emissions-intensity test is used.

Impacts of the Proposed Safeguard Mechanism

The proposed safeguard mechanism rules will inevitably result in costs inflicted on Australian refineries and smelters that are higher than the carbon costs being imposed on facilities they compete against in global markets. Australia's main aluminium competitors are located in countries such as China, the Middle East and Brazil. While some of these countries have emissions reduction policies, they do not impose comparable carbon costs on their alumina refineries and aluminium smelters to those that will be imposed by the safeguard mechanism in Australia.

This means that the safeguard mechanism will impose higher costs on some of the world's best facilities, limiting growth of valuable assets to our economy.

The proposed safeguard mechanism rules require continuous improvement on previous best emissions intensity levels – this creates problems for facilities that have historically performed very well. Australia already has some of the top refineries in the world for carbon emissions-intensity. To impose financial penalties for failing to make year-on-year improvements to already low levels of emissions-intensity creates another hindrance for Australian facilities in an international market where many competitors have not invested the same capital in order to improve efficiency, and would not face equivalent penalties from their governments.

This situation is exacerbated further by the rules not allowing the use of offsets to meet the emissions-intensity test, but instead requiring the purchase of offsets to return to the absolute emissions baseline – a level that was established from a (perhaps significantly) lower level of production.

Furthermore, the rules could create a perverse incentive for a facility not to improve emissions in case they “overshoot” and face a more difficult hurdle to clear in future.

Offset Purchase for Business As Usual Operation & Possible Solution

The circumstances that are likely to occur at many of our facilities that will create a significant cost are:

- Production levels increase, and are sustained, above the highest level of the baseline period;
- Absolute emissions also increase above the highest level of the baseline period; and
- Annual variation (known as noise) is present around a trend of gradual long-term improvement in emissions intensity.

This would mean significant cost under the proposed rules, as follows:

- The absolute emissions baseline will be exceeded from production increases, and will be repeatedly exceeded in future years;
- Multi-year averaging of absolute emission levels cannot resolve the problem, as emissions will not drop back below the absolute emissions baseline;
- While the emissions-intensity test may offer relief in some years, the natural variation in emissions intensity means that once the emissions intensity test has been utilised in a “low” year, then the facility is likely to fail the emissions intensity test in future (as year-on-year improvement is required);
- Given that multi-year averaging does not provide relief, compliance will be required back to the absolute emissions baseline which will generate a significant cost – for example, production and emissions increases of 5-10% would require purchase of ACCUs for that amount of emissions.

Our proposed option is to not reset the emissions-intensity baseline each time the variation in baseline determination is applied, but maintain the emissions-intensity baseline from the same year as the initial determination.

ACCUs

The Council notes that Australian Carbon Credit Units (ACCUs) will be the primary means of compliance for facilities that exceed their baselines. There is a risk that the demand for ACCUs may exceed supply, creating either significantly increased costs of compliance or the risk of non-compliance. It would be appropriate to have a measure to constrain the cost increases or risk of non-compliance such as a price ceiling or availability of an alternative means of compliance.
