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Minimising the hurt in an emissions scheme

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Simcoa is a little-known company which operates Australia's only silicon smelter at Kemerton, 160 kilometres south of Perth.

Simcoa uses large amounts of electricity to raise temperatures inside its arc furnaces to 3000 degrees, triggering reactions which turn quartzite and charcoal into the metalloid silicon.

It employs 120 people and has export sales of about $100 million a year.

Under the Federal Government's plan to tackle climate change by making industry pay for the environmental costs of greenhouse gas emissions, Simcoa is sitting pretty.

It will qualify for the maximum level of assistance the Government is offering emissions-intensive companies competing against international rivals who will not pay a price for their emissions.

Woodside Petroleum is a home-grown multinational which operates the giant North West Shelf gas project off the coast of Western Australia.

It also uses large amounts of energy, to refrigerate natural gas to 162 degrees below zero, condensing it into liquefied form for shipping to export markets.

Woodside employs 2900 people. The North West Shelf generates several billions of dollars a year in export sales.

Yet under the Government's plan, Woodside will not qualify for any help.

Why should polluters be assisted at all? After all, emissions trading is designed to make them pay for the environmental costs of their operations, creating an incentive to clean up their acts.

But a big problem arises if an Australian polluter pays a carbon price but competes against polluters from other countries which face no such cost.

Here the customer will switch to the lower-cost producer. Australia will lose lucrative export sales. And the environment will suffer because the low-cost producer has no incentive to cut emissions. The climate change expert Ross Garnaut called this as a "truly dreadful problem".

The best solution would be for all countries to cap emissions. Then all producers would pay a carbon price and compete on a level playing field.

A second-best approach is international sectoral agreements. These would impose a carbon tax on emissions-intensive producers operating in countries which do not cap emissions.

But the Government believes climate change is so urgent it cannot wait for such international deals to be thrashed out.

So it has chosen a third-best solution, temporary help to emissions-intensive and trade-exposed (EITE) producers by way of free permits under the emissions trading system.

Last month's emissions trading green paper set out detailed formulas for working out which activities will qualify for assistance and how many permits they will get. The starting point is that 30 per cent of each year's permits will be given free to EITE firms.

Using 2001-02 industry-level data, the Government works back from this figure to calculate an emissions-intensity threshold which would qualify an industry for assistance.

This magic number is annual emissions of 1500 or more tonnes of carbon dioxide or its equivalent for every million dollars of revenue.

Recognising that the data is dated and that activities lumped inside wider industry categories have different emissions profiles, the Government then fiddled with the numbers to come up with an illustrative list of activities meeting the threshold.

Simcoa's silicon smelting made it onto the list. Perhaps the Government's boffins expected Woodside would also make it. But it doesn't even come close, which has given ministers serious pause for thought given the North West Shelf's strategic economic importance.

The green paper will trigger two different responses by EITE firms.

Many will have their own boffins furiously working out how to tweak the formula or slice and dice the data to ensure they qualify.

Yet for every company which gets onto the list through this numbers game another company must fall off.

So many industry groups, especially those in LNG, will push for the whole approach to be junked, arguing that it will put the economy in jepoardy. They will ask the Government to use the United Nations climate change talks to negotiate an emissions cap which does not put Australia at a competitive disadvantage.

But Labor won the election with the promise of early action on climate change so will find any delay to emissions trading politically unpalatable.

Yet the green paper's approach will create intense lobbying for the EITE formula to be recalibrated, more pressure in future for the rules to be changed as economic circumstances change, and calls to punish with a carbon tariff countries whose producers take "our" jobs .

Last week the chairman of the Productivity Commission, Gary Banks, offered the following solution: "There is much to be said for starting with very low effective prices for carbon until major global emitters also take action, but to signal to business that future prices are likely to climb steeply."

The Government could do worse than listen to its most-experienced econocrat in the business of sorting out unjustified industry special pleadings from genuinely welfare-maximising policies.