Caltex Australia opening statement to Senate Select Committee on Climate Policy inquiry into Climate Policy

Thank you for the invitation to appear before the Senate Select Committee.

Our focus for this inquiry has been on those sections of the terms of reference of most relevance to Caltex which include:

b. the relative contributions to overall emission reductions from complementary measures
c. whether the Government’s Carbon Pollution Reduction Scheme (CPRS) is environmentally effective
e. the design of the proposed scheme taking into account permit allocation
f. any other matter

Caltex would like to make the following key points to the committee:

- the CPRS (or an alternative emissions trading scheme) should not start effective operation until properly designed and economic conditions return to normal
- the international competitiveness of emissions-intensive, trade-exposed industries should be fully maintained (for example through a 100% free allocation of permits under the CPRS) until overseas competitors have equivalent carbon costs
- the excise reduction for motorists and certain other fuel users under the CPRS has made their inclusion environmentally ineffective for many years yet will create massive churn in emission permits
- as a consequence, private motorists and some commercial users should be excluded from the CPRS and simple, practical proposals are made to achieve this
- various complementary measures should be implemented to help reduce emissions from transport.

Background

Australia’s annual greenhouse gas emissions were 576 million tonnes (Mt) in 2006, the most recent year for which data has been published. Of this total, 46 Mt was from petrol, 44 Mt from diesel, 25 Mt from jet fuel/other petroleum products, a total of 115 Mt or 20% of total Australian emissions. Of this total, transport (road, rail and sea) accounted for 79 Mt or 14% of Australian emissions.

In percentage terms, about 8% of Australian emissions were from use of petrol, 8% from diesel and 4% cent from jet fuel and other fuels. To manufacture these fuels, Australia’s seven operating oil refineries emitted directly about 6 Mt or 1% of Australia’s emissions.

Caltex estimates emissions from combustion of liquid fuels will reach 150 Mt by 2020 comprising approximately 41 Mt from petrol, 73 Mt from diesel, 37 Mt from jet fuel/other petroleum products. Refinery emissions will be similar to 2006.

As a company, Caltex emits about 2.1 million tonnes directly (about 2 million tonnes from refining and 0.1 Mt from marketing and distribution activities) and about 0.4 million tonnes indirectly, from purchased electricity. Our products, once used by our customers, emitted another 35 million tonnes in 2005, mainly from vehicles. Customers’ emissions will increase, particularly from growth in diesel and jet fuel. Caltex estimates these emissions will reach 42 Mt in the first year of the CPRS, approaching 10% of the permit market of about 480 Mt when refinery emissions are included. Caltex’s customer emissions will be almost 20 times Caltex’s own emissions.
Because Caltex must purchase permits for its customers' emissions as well as its own emissions, it will be Australia's largest single purchaser of emission permits so has a vital interest in the effectiveness of climate change policies. Assuming 75% of permits are auctioned, Caltex's permit requirements will be about 12% of the permits available at auction.

Caltex is the largest refiner and marketer of petroleum products in Australia with operations in all states and territories. Caltex has achieved the leading market share for supply of transport fuels and is the number one convenience store operator through its branded retail network. It has an estimated market share of more than 30 per cent of the major transport fuels (petrol, diesel and jet fuel) supplied nationally.

Caltex accounts for around 35 per cent of Australia’s oil refining capacity. It owns and operates two of Australia's seven oil refineries – at Kurnell in Sydney and Lytton in Brisbane. Between them, the Caltex refineries have the capacity to process 244,000 barrels (about 39 million litres) of crude oil per day.

Caltex produces mostly high-value transport fuels which contribute to the growth of the economy and provide significant employment. The two refineries directly employ 874 Caltex employees and around 550 contractor employees. For major maintenance and other projects the numbers can escalate by an extra 1,200 workers, bringing the total number of workers to about 2,600.

Caltex refineries will spend an average of $100 million per year over the next three years on capital expenditure and approximately $60 million per year on the major maintenance projects that are required regularly in all oil refineries.

The CPRS as currently proposed will significantly reduce our international competitiveness and the purchasing of permits on behalf of our customers will place an inequitable and disproportionate financial risk and cost on the business.

The timing of emissions trading should allow for proper design and economic conditions

- The timing of introduction of an emissions trading scheme (ETS) such as the CPRS is less important than ensuring the scheme is properly designed. The two most important design criteria for Caltex are fully maintaining the international competitiveness of our two oil refineries and effectively reducing the impact of emissions from combustion of petroleum products while avoiding the financial risk and cost associated with having to purchase permits for our customers’ emissions.
- While Caltex supports an ETS as the primary tool for reducing point source greenhouse gas emissions, it does not have a view as to whether a cap and trade model is the best form of an ETS for Australia or alternatives such as a baseline and credit scheme could be superior. This would have to be judged against general ETS design criteria as well as Caltex’s specific criteria discussed above.
- Regardless of the time taken to achieve a properly designed ETS, economic conditions currently make it difficult to absorb any costs that would be created by the CPRS. In particular, the global oil refining industry is under great pressure from reduction in demand for petroleum products and resultant excess capacity and this adversely affects the gross margins for refinery production in Australia. Most other industries are adversely affected by global and Australian economic conditions and Caltex suggests that the CPRS (or any alternative ETS) not be implemented until economic conditions return to normal i.e. economic growth is similar to historical levels and profitability in the oil refining industry reflects those conditions.
- Caltex does not suggest abandoning work on an ETS. On the contrary, we believe work should continue in order to fully investigate all key design issues prior to a complete and integrated package being put to the Parliament. The current process has
not allowed sufficient time for development of the full package of legislation and supporting regulation, nor will it provide the Parliament with an opportunity to debate and amend the package. We are particularly concerned that certain key design elements such as regulation of emission-intensive trade-exposed (EITE) industries will be presented to Parliament on a "take it or leave it" basis in regulation rather than being embodied in legislation so subject to amendment.

- Caltex notes that the slowdown in economic activity will probably reduce emissions in the Kyoto Protocol first commitment period (2008-2012) so as to allow an ETS start date later than 2010 and/or a period in which the ETS can be trialled without creating adverse economic impacts i.e. no money would be required to purchase permits. Caltex would support a later start in order to allow for proper ETS design and Parliamentary consideration and a trial period for business to test the scheme and business systems to administer it.

The competitiveness of emissions-intensive, trade-exposed industries must be maintained

- Caltex’s two oil refineries will emit in total about 2.5 million tonnes of carbon dioxide equivalent (MtCO\textsubscript{2}e) annually when the CPRS is in operation. At the CPRS-5 price scenario, this will result in a permit cost of about $25 million pa in the early years of the scheme, increasing to about $35 million (in $2005) by 2020. At the CPRS capped price, the permit costs would be $40 million pa and $60 million respectively. These figures assume a nominal rate of 60% free permits and 1.3% pa carbon productivity contribution reduction. These permit costs will not be recoverable because the prices of petroleum products from Caltex’s refineries are based on import parity and none of the overseas refineries that are our direct competitors (e.g. in Singapore and Korea) seem likely to adopt equivalent carbon costs for the foreseeable future.

- In order to fully maintain international competitiveness, Caltex proposes that activities such as oil refining where prices are completely aligned with import parity should receive a free allocation of permits equal to 100% of Scope 1 and Scope 2 emissions, until such time as all significant import competitors face equivalent carbon costs. For oil refining these competitors would include Singapore, India, Korea, Japan and China. Failure to provide such permits would result in reduced investment in Australian refining and loss of competitiveness, potentially leading to refinery closures and replacement of Australian production of petroleum products with overseas production.

The CPRS is ineffective and creates massive permit churn due to the excise reduction

- All petroleum products supplied from Australian terminals, whether sourced from imports or local refineries, will be subject to a carbon permit liability. The point of carbon liability will be aligned with the point of excise liability. The CPRS proposes that suppliers from terminals will have an "upstream point of obligation" i.e. will be required to purchase permits for customers’ emissions, which they will then recover by increasing the prices charged to customers. This CPRS design feature will make Caltex the largest single purchaser of permits in Australia at over 40 million tonnes pa or about 12% of the permits available at auction from the Australian Government. These permits will cost about $0.9 to $1.6 billion pa based on the CPRS-5 and price cap carbon price scenarios.

- The requirement to purchase such a large quantity of permits creates the risk of under-recovery of costs that could be significant relative to Caltex’s profitability and imposes large working capital costs and debt-raising requirements. For example, if permits were purchased in 12 equal amounts, this would require an additional $80 to $130 million in capital, which is significant in relation to Caltex’s total debt.
The inclusion of liquid fuels in the CPRS, in particular fuels used in transport, is questionable on the grounds of environmental effectiveness. The elasticity of petrol demand with respect to price is low, about -0.15 in the short run and about -0.4 in the long run. In other words, a 1% increase in price would reduce petrol demand 0.15% to 0.4%. In addition, petrol prices are high due to world oil prices and Australian taxes so the effect of a carbon cost is very small. Caltex calculates that a carbon cost of A$40/tonne of carbon dioxide would increase prices only 10 cents per litre (cpl) and reduce demand by 3.2% in the long run, far short of the massive reductions required by 2050. On these grounds alone, the inclusion of transport in the CPRS is of marginal effectiveness and complementary measures will be required to achieve large emission reductions.

The situation with the CPRS is actually far worse in terms of emission outcomes because of the introduction of excise reductions for various classes of petroleum product consumers. The CPRS will actually increase emissions from petrol for several years because the excise reduction is greater than the carbon price for the first three years and several years beyond that time. In fact, under the CPRS-5 price scenario there will be no overall (i.e. cumulative) reduction in emissions from petrol for the first three years and several years beyond that time. At the same time, petrol suppliers will have purchased $20 billion in permits and charged these back to customers - financial churn for no environmental benefit.

In relation to diesel, the situation is not as bad. There would be no impact on emissions from private motorists and light commercial users for the first three years of the CPRS and reduced emissions after that time. While it is difficult to calculate the emissions impact, an indicative calculation assuming diesel has half the price elasticity of petrol suggests the excise reduction would stifle emission savings from diesel consumed by cars and light commercial vehicles, leading to only a 1% cumulative reduction by 2020 compared to a 8% cumulative reduction without the excise offset.

Motorists and certain other fuel users should be excluded from CPRS

The excise reduction means that certain consumers - primarily private motorists and commercial users not eligible for a fuel tax credit - have been effectively removed from the CPRS for many years. Caltex therefore proposes the CPRS be amended to remove private motorists and other small consumers from the CPRS and to address the issue of emission reduction from these consumers through complementary measures.

There are various legislative options to achieve this but Caltex advocates either: liability for emissions for permits to apply only to emissions above the CPRS liability thresholds e.g. 25,000 tpa for a facility; or liability to apply to all consumers receiving a fuel tax credit, which in practice would include all emitters above the CPRS threshold and some smaller but still significant business emitters. In the former case, the liability would be to surrender permits, as for emissions from other sources. In the latter case, the fuel tax credit would be reduced by an amount calculated from historical carbon prices, in exactly the same way as proposed under the CPRS. These options retain large emitters from petroleum products within the CPRS and are administratively simple and consistent with current CPRS design.

Complementary measures are required to reduce transport emissions

Complementary measures will be required to help reduce emissions from vehicles regardless of whether all vehicles are inside or outside the CPRS. Caltex believes that changes in vehicle technology will be the key to reducing emissions, together with greater reliance on alternative fuels.

Australia should encourage consumers to purchase the most fuel efficient vehicles available from Europe, the US and other regions and monitor carbon efficiency (in grams/kilometre) against a set of voluntary targets that are comparable to other countries. Consumers could be provided incentives to purchase these vehicles through...
a “feebate” scheme that provides “cashbacks” for low emission vehicles, funded by fees on higher emission vehicles.

- In addition, there should be grants provided for research, development and demonstration of low emission vehicles and low carbon fuels, tailored to developing Australian manufacturing capability and fuel distribution infrastructure.
- Other policies could include consumer education, improved public transport and road management, and better urban planning to reduce transport emissions.

Mr Frank Topham
Manager Government Affairs and Media
21 April 2009