

Energy Efficiency Inquiry
Productivity Commission
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15 March 2005

Re: Inquiry into Energy Efficiency

A3P, the Australian Plantation Products and Paper Industry Council, welcomes the opportunity to provide input to the Productivity Commission's Inquiry into Energy Efficiency. The industry represented by A3P consists of a number of sectors with differing intensities of energy use. The plantation growing sector is a relatively low intensity user of energy, the sawmilling sector is a moderately intensive energy user, while the reconstituted board and paper processing sectors are substantial energy users in absolute and energy intensity terms. Many participants in the industry are also significant producers of energy from wood and processing residues. The combined energy use of the industry is approximately 2.0% of the total Australian energy consumption of both gas and electricity.

Summary

If a higher level of energy efficiency than achieved through normal business processes is desired, to realise other benefits, there should be some financial transfer from the receivers of those benefits to the party taking the action.

The mechanisms available to undertake this transfer include:

- Acknowledgement of the extra benefits through financial and tax treatment such as accelerated depreciation rates.
- Availability of funds to undertake feasibility studies into energy efficiency projects.
- Ensure the scope of programs such as the Low-Emission Technology Development Fund include projects of all sizes and are available to assist in the viability of a wide range of energy efficiency projects.

The plantation products and paper industry produces and sells more than \$12 billion of product each year. It employs 50 000 people in plantation operations, sawmills and paper manufacturing plants, mainly in rural and regional areas. The industry produces 15 million tonnes of wood annually, and processes this wood into products including 3 million tonnes of paper and 3 million cubic metres of sawn timber.

The industry, particularly the paper and board sectors, is exposed to significant market competition from overseas production facilities. Energy costs are a substantial proportion of the total production costs for paper (up to 20%) and reconstituted boards. A key source of competitiveness for Australian production in both domestic and export markets is the supply of reliable, competitively priced energy.

As a result of these factors, government policy on energy issues such as pricing, the operation of energy markets and energy efficiency have a significant influence on the viability of domestic production and the attractiveness of further investment in Australia.

Energy Efficiency in the Plantation Products and Paper Industry

Clearly market and economic forces already provide a strong incentive for energy efficiency within the industry. These forces have seen energy consumption in the paper sector reduce from 22.2 GJ per tonne of production in 1990 to 16.8 GJ per tonne of production in 2003, a 24 per cent improvement in energy efficiency. These reductions have been achieved through machine upgrades, investment in new plant and process-based improvements.

Corporate Decision-Making

There are a number of key elements in most corporate decision-making processes that are relevant when considering if impediments exist to investment in energy-efficiency projects.

In any organization, there will be more theoretically 'profitable' projects available than there are funds for investment. The criteria for selecting projects to fund will vary between companies but is likely to include three common elements:

- An assessment of the rate of return on funds invested. Obviously projects with higher or faster rates of return are more likely to be funded.
- The level of risk associated with the project, including the probability of achieving lower rates of return or losing money.
- The strategic importance of the project with respect to maintaining or expanding key markets, improving product quality or changing customer perception of the product.

Discussion of energy-efficiency projects often focuses on the first of these criteria and it is undoubtedly a crucial issue. While many energy efficiency projects may be 'profitable', they may be less so than other potential investments available to the company. However the second and third criteria may be more relevant in explaining why energy-efficiency projects may fail to get funded.

The level of risk in a project is obviously related to a variety of market and operational factors but will also be influenced by the expertise and background of those making the decisions. It is possible that investment in energy-efficiency projects would be enhanced if there was an increased knowledge of energy issues in key decision-making roles and therefore less likelihood that such investments would be perceived as 'risky'.

It is unlikely that energy efficiency projects, on their own, will lead to major strategic benefits such as improved product quality or the development of a new product. In many instances, projects that are essential to hold onto a particular market segment or improve product quality to meet customer expectations will be funded first, due to the significant consequences of failing to implement the project. Energy efficiency projects, though 'profitable' may attract a lower priority if they do not provide quantum shifts in product quality or range.

Energy Efficiency Projects

The discussion above, and much of the consideration of energy efficiency, assumes that improvements are made by implementing discrete energy-efficiency projects. However, improvements in energy-efficiency are more likely to be achieved through projects that are motivated by a variety of benefits, of which energy efficiency is only one, or projects that are motivated solely by other benefits where energy efficiency is a by-product. Reducing production costs is a strong imperative in most businesses. Given energy costs are a large component of production costs for the plantation products and paper industry, improved energy efficiency will generally result from an integrated approach to minimising production costs.

Companies operating in trade-exposed industries experience significant and consistent pressure to optimise overall efficiency. It is important for the viability of those businesses that any Government policies designed to improve energy-efficiency harness that pressure rather than dilute it or add costs and confusion.

Opportunities to improve energy efficiency are not evenly distributed over time or through the industry. The greatest potential for improvement occurs when plant or machinery is being replaced or updated. It is unlikely that energy efficiency gains alone will be sufficient to substantially alter the timeframes for plant and machinery upgrade, but when these opportunities are created by market and financial forces, an opportunity is also created to maximise the energy efficiency improvements.

Policy Options

The Issues Paper raises a number of questions regarding the need for Government intervention and the benefits of national coordination and uniformity. It seems axiomatic to state that industry would benefit from a single national approach to issues such as energy efficiency and greenhouse policy.

Furthermore the cost-effectiveness of these policies will be enhanced if they:

- Directly address the issue, such as through incentives for the activity desired, rather than the imposition of reporting requirements or other costly measures.
- Allow industry to determine the most efficient means of achieving the desired outcome and are not constrained to particular technologies or sectors.
- Structured simply so that Governments, industry and the public can clearly understand the desired outcome and how the policy will achieve that outcome.
- Remain stable so that business can implement processes and systems that deliver the required outcomes on an ongoing basis and minimise the costs of compliance.

Energy Market Reform

The Energy Market Reform Program includes a workstream on energy efficiency that clearly needs to be informed and guided by the outcomes of the Commission's Inquiry. However other elements of the Reform Program also have an impact on energy efficiency.

A key objective of energy market reform is greater involvement of users in energy markets and better servicing of user's needs. In turn, it would be expected that users will respond with a greater comprehension of energy costs and increased awareness of energy issues and the potential for savings through improved efficiency.

Key initiatives include those that increase user control of their energy costs and improve the quality of market signals between users and suppliers. In this respect, the development of demand management systems and cost-reflective pricing, though not directly increasing energy efficiency, will improve the ability of users to be aware of, and respond to, opportunities for improved energy efficiency.

Approaches to Assist Energy Efficiency

If the pursuit of overall efficiency by a business does not achieve the level of energy efficiency desired by government or the public, this suggests the existence of a benefit from energy efficiency that does not accrue to the business.

If a higher level of energy efficiency is desired to realise these other benefits, such as reduced greenhouse gas emissions, then there should be some financial transfer from the receivers of those benefits, presumably the public, to the party taking the action. This is based on the 'beneficiary principle', the notion that those who benefit from the provision of an activity or product should pay for it.

Any approach such as this should be broadly based so that all opportunities to improve energy efficiency are treated and rewarded equally. There is no justification for restricting support to certain technologies or within certain industries as the desired benefits will accrue from any method of improving energy efficiency.

There are currently a number of schemes at state and national level to report on energy use, energy efficiency and opportunities for improvement. The imposition of additional energy efficiency targets or reporting requirements would not be an effective means of increasing the uptake of energy efficiency projects. They do not change the financial returns or risk of projects and therefore do not transform a previously inefficient project into an efficient project. A single, streamlined national reporting framework would be a more effective method of monitoring energy efficiency than fractured state-based schemes.

Similarly, programs that provide incentives only for certain technologies or approaches, risk using public funds to achieve inefficient outcomes.

Policies and measures relating to energy efficiency need to be sensitive to the significant achievements already made by some companies and the difficulties in comparing energy efficiency performance between plants. The potential for further improvements is strongly influenced by the age of plant and machinery. A company that has just replaced or updated plant and machinery has fewer opportunities to further improve energy efficiency than a company that is about to update.

Arbitrary energy efficiency targets or reporting requirements cannot cater for these variations without becoming overly complex and burdensome. A broad based approach that improves the attractiveness of investment in energy efficiency will provide incentives for action where they will be most effective and avoids punishing early movers.

Possible Government Initiatives

As discussed above, Government intervention to achieve improved energy efficiency must be a broad approach that harnesses the existing knowledge, expertise and competitive pressures. It should avoid arbitrary targets, costly reporting mechanisms and measures that try to pick winners in technology or industries.

The policy should reflect the underlying issue being addressed, that is, (if) there is a larger benefit to the public from increased investment in energy efficiency, there should be a transfer/payment to create the incentive for extra investment.

The mechanisms available to undertake this transfer include:

- Acknowledgement of the extra benefits through financial and tax treatment such as accelerated depreciation rates. This would increase the rate of return for energy efficiency investments, increasing their likelihood of being funded.
- Availability of funds to undertake feasibility studies into energy efficiency projects. This may help address the relative lack of expertise and knowledge of energy management at decision-making levels within companies.
- Ensure the scope of programs such as the Low-Emission Technology Development Fund include projects of all sizes and are available to assist in the viability of a wide range of energy efficiency projects.

Although the Low-Emission Technology Development Fund has yet to be fully implemented, the current definition of its objectives and scope focuses on large projects that require assistance to demonstrate their commerciality. While this is an important initiative, it will not assist the viability of a wide range of projects at a smaller scale, and using existing technology, that are currently not being funded.

Thank you for the opportunity of commenting on the Productivity Commission's Inquiry into Energy Efficiency. A3P looks forward to the Commission's draft report. If any part of this submission requires further explanation please contact me at the address above.

Yours sincerely

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