

09 May 2011

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Dear Sir/Madam,

### **PROPOSED ARCHITECTURE AND IMPLEMENTATION ARRANGEMENTS FOR A CARBON PRICING MECHANISM**

Queensland Magnesia Pty Ltd welcomes the opportunity to respond to the proposed architecture and implementation arrangements for a carbon pricing mechanism developed by the Multi-Party Climate Change Committee (MPCCC) and announced by the Prime Minister on 24 February 2011.

#### **Corporate Background**

Queensland Magnesia Pty Ltd (QMag) is located in Rockhampton, Queensland and is Australia's largest producer and exporter of the industrial mineral product magnesia, also known as magnesium oxide (MgO), accounting for over 95% of the Australian magnesia industry.

QMag's mineral deposit has a currently estimated resource life of over 40 years. The QMag operation adds significant value to a low-value industrial mineral resource, magnesite, in a single vertically integrated operation that operates using state of the art processing techniques and technology and to world's best practice standards for the magnesia industry. QMag exports the majority of its production to numerous customers throughout the world, as well as supplying a large part of Australia's requirements for these products. QMag's magnesia products are recognised as being amongst the highest quality and QMag as one of the most reliable suppliers in the world. The business operates under certified ISO14001 environmental management and ISO9001 quality management systems.

QMag has grown over the past two years and diversified its product range and customer base worldwide in an attempt to improve what have been historically poor financial returns. The company has invested in a major \$48M 3<sup>rd</sup> multiple hearth furnace expansion project to improve operating efficiency and economies of scale.

QMag provides substantial economic and social benefits to the community of Rockhampton and Central Queensland. Current direct employment is 380 people and it is expected to increase to over 400 within the next few months. It is estimated that total direct and indirect employment by QMag in the Rockhampton region exceeds 1,000 people. For the financial year 2009/10 QMag contributed approximately \$86M to the Central Queensland economy in the form of supplier payments, salaries and wages and direct community contributions.

The production of magnesia, as undertaken by QMag, is recognised as an EITE activity in Schedule 6, Part 12 of the Renewable Energy (Electricity) Regulations 2001.

#### **General Position**

QMag is opposed to a unilateral response by Australia to climate change issues in the form of a carbon pricing mechanism on magnesia. The primary reasons for this are as follows:

- Prima facie, the imposition of a carbon price on the Australian magnesia industry, without a simultaneous global introduction, will unfairly disadvantage the Australian industry relative to its international counterparts and also cause job losses and loss of income to Australia;
- A carbon price on magnesia in Australia will simply transfer magnesia production offshore (carbon leakage) to countries with a higher emissions intensity than Australia, causing a rise in overall world carbon dioxide levels: A worse environmental outcome;
- Carbon dioxide is a necessary by-product from the chemical reaction required to produce magnesia. The carbon dioxide must be released from magnesite ( $MgCO_3$ ) to produce magnesia ( $MgO$ ). There is no alternative production method to avoid carbon dioxide releases in this process and the quantity released cannot be reduced; and,
- The presence of a significant number of highly-respected opposing views in the scientific community with regard to the extent and causes of climate change.

If a carbon pricing mechanism is to be introduced, the impact of carbon pricing on the company should be **fully** mitigated by excluding magnesia from the scheme, or alternatively, through the issue of 100% compensatory offsets as part of the operating mechanism once it is fully developed.

### **Specific details to be considered**

Specific details concerning the magnesia industry and market place that QMAG would like to be considered in developing the proposed architecture and implementation arrangements for a carbon pricing mechanism are as follows:

- QMAG participates in the international traded market for magnesia but does not have the market size or market power to influence the overall direction of magnesia prices. QMAG is a price taker in world markets and in Australia;
- QMAG supplies less than 10% of the world traded magnesia market. The major producer and dominant force in world magnesia markets is China; it is China that sets world pricing.
- China has large reserves of magnesite, much of which is processed by low cost methods, partly due to the fact that Chinese industry does not have the same requirement to reduce emissions intensity and improve safety as in Australia. The Chinese magnesia industry has a higher emissions intensity than Australia;
- There are also large reserves of magnesite in Brazil, Russia and North Korea and these countries are emerging as significant competitors to QMAG in the international traded magnesia markets;
- The cost of carbon is not considered in the setting of world magnesia prices and there is little likelihood that carbon will form part of the international price structure for magnesia in the foreseeable future. This is because countries such as China, Brazil, Russia and North Korea have no plans to implement a carbon pricing mechanism;
- It would not be possible to pass on cost increases resulting from carbon being embedded in the cost structure of QMAG products produced in Australia;
- Increased costs as a result of a carbon pricing mechanism would threaten the viability of QMAG and the approximately 1,000 direct and indirect jobs that rely on QMAG in the Rockhampton region. QMAG's owners and management have taken steps to restore profitability and create a secure future for the company, but these efforts will be undermined by the introduction of carbon costs on QMAG's products;
- A carbon pricing mechanism without 100% assistance to magnesia in the form of free permits or equivalent could result in the closure or reduction in the Australian magnesia industry with consequential harm to the Rockhampton and central Queensland economy;
- Most magnesia production world-wide (particularly in China), occurs in less efficient kilns, often fired with coal, coke and heavy fuel oil with much higher levels of emissions intensity;
- Conversely, QMAG utilises the latest magnesia production technology, worlds best practice production techniques and a clean, low greenhouse gas emission source of fuel (coal seam methane gas). QMAG also participates in the Federal Government Energy Efficiency Opportunities (EEO) program;

- A carbon tax on Australian magnesia will shift production to countries that are not subjected to an emissions constraint and a worse overall, global emissions outcome will result.
- Over half of the carbon emissions produced by QMAG result from carbon dioxide process emissions arising during the chemical reaction that transforms magnesite into magnesia. These process emissions cannot be reduced by QMAG without reducing or ceasing magnesia production completely. There is no known technology to reduce the chemical release of carbon dioxide in the production of magnesia. CO<sub>2</sub> must be released from MgCO<sub>3</sub> to produce MgO; and,
- Funds diverted into paying a carbon price will potentially suppress rather than enhance emissions intensity improvements as it will draw upon limited and fixed financial reserves that could otherwise be applied to improvement projects.

### **Specific Elements of Proposed Architecture**

#### *Start date:*

The proposed start date of 1 July 2012 is considered too early for the commencement of a carbon pricing mechanism. QMAG considers that sufficient time to implement the proposals should be allowed, as described below. Further, the proposals should be taken to the next federal general election and implemented upon return of the government and not before.

QMAG anticipates that there will be a comprehensive and vigorous debate in relation to the proposed carbon pricing mechanism prior to its introduction. This debate has only recently commenced and details of the potential operating arrangements of the mechanism are currently only of an overview nature and have not yet been fully developed.

Once a detailed mechanism has been developed the next steps of communication to industry and businesses should be extensive to allow for a proper understanding of the mechanism, the assessment of economic impacts on individual businesses and the implementation of appropriate business processes to bring the mechanism into effect.

A more realistic date for commencement would be after the next general election and at the start of the next financial year that commences 12 months after the relevant legislation has been passed.

#### *Length of fixed price period and transition arrangements:*

It is not possible to assess and comment on the extent of a fixed price period in the absence of information with respect to the quantum of the proposed fixed price, escalation factor and estimates of the flexible price to be applied. The fixed price time period and applicable pricing are inextricably linked and to consider a position on one variable in the absence of the others may lead to incorrect conclusions. To assess the overall impacts it is necessary to know the proposed values of all relevant variables.

For example if the proposed fixed price is significantly less than the estimated flexible (market-based) price, then the fixed price period should be long enough to ensure that annual increases are minimised as the fixed price rises over time towards the expected flexible price level. Conversely if the fixed price is greater, or becomes greater via escalation than the expected flexible price, then the fixed price period should be reduced to ensure rational pricing outcomes.

QMAG concurs that setting any fixed carbon price and transitioning from a fixed to a flexible price arrangement should be closely tied to relevant developments in carbon emissions pricing at the international level. Indeed it is suggested that the initial fixed price be very close to zero to reflect current international approaches and practice in pricing carbon by Australia's competitors.

#### *Coverage:*

QMAG notes that the broad architecture suggests a carbon price mechanism could cover all greenhouse gases recognised under the Kyoto Protocol and that a broad coverage of emissions sources has been proposed. A carbon price should only be introduced on those greenhouse

gases, and only on those emission sources, that are subject to international carbon price impositions by the major world economies and by Australia's trading partners and competitors.

QMAG would like to better understand how it is intended that emissions will be measured and assigned to liable entities under the proposed arrangements. QMAG notes that these issues are expected to be particularly problematic in relation to the transport sector and for fugitive emissions.

As noted above, if a carbon pricing mechanism is to be introduced, QMAG requests that the impact of carbon pricing on the company be fully mitigated by either full exclusion of magnesia from the scheme or through the issue of 100% compensatory offsets as part of the operating mechanism once it is fully developed.

*International linking:*

If a scheme is introduced then credits should be available for international offsets from the commencement date to assist reinforcement of the global nature of climate issues. QMAG concurs that the international emissions units should be available as offsets only to the extent that they match the qualifying criteria (once established) of national emissions units.

*Assistance and other matters still to be determined:*

QMAG notes that there are many aspects of the proposed carbon price mechanism still to be developed. QMAG endorses the MPCCC's principles that have been established to guide the further development of the mechanism.

In particular, QMAG endorses the MPCCC principle of competitiveness that recognises that the overall package of carbon price design and assistance packages should take appropriate account of impacts on the competitiveness of all Australian industries. In this regard QMAG requests that the impact of carbon pricing on the EITE activity of magnesia production be fully mitigated to ensure the Australian Magnesia Industry's ongoing operation and competitiveness.

**Conclusion**

QMAG acknowledges that the Government wishes to take action on greenhouse gas emissions. Response to this issue can take many forms. However, whatever path is chosen the integrity and competitive position of the Australian economy must be maintained.

The Australian magnesia industry should be excluded from carbon tax proposals, or alternatively receive 100% support with respect to carbon costs, until the principal competitor countries such as China, Russia, Brazil and North Korea introduce similar schemes. This is required to ensure the continued viability of the Australian magnesia industry and the employment and economic benefits it provides to Rockhampton, Central Queensland and the Australian economy in general.

A unilateral response to greenhouse gas emissions by Australia will shift production from Australia to parts of the world where emissions intensity is higher, leading to a worse global carbon outcome and force companies like QMAG to close. To ensure maximum benefit to the global environment, Australia should not penalise nor replace efficient local production with increased production from more emissions intensive industries in China or other competitor countries.

Yours sincerely,



Alan Roughead  
Managing Director