CLIMATE ENERGY FINANCE

Reforming the Fuel Tax Credit Scheme is not 'economy-wrecking', but will align economic incentives with Australia's climate ambition and accelerate our pathway to a Future Made in Australia

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29 August 2024

Climate Energy Finance (CEF) advocates for a $50m per group per annum cap to the diesel fuel subsidy, and for all tax receipts to be returned to the mining firms impacted if they are reinvested in deployment of electric vehicles (EV) and the enabling renewable energy infrastructure. This cap would limit this reduced subsidy to eight of the largest mining firms in the world, turning a headwind to decarbonisation into a tailwind, and therefore aligning with Australia's national interests in terms of improved energy security and acting in alignment with the climate science.

Last week, the Australian published an article promoting a warning to the Federal Government by the Fuel Tax Credit Alliance that reforms to the current Fuel Tax Credit (FTC) Scheme would inflict severe damage on the economy, drive up grocery prices, and result in job losses across the country.[1]

The article references a report on the importance of continuation of seventy years of public subsidisation of high emission imported fossil fuel consumption to protect domestic agriculture, fishery, tourism, road transport, construction and building industries from further input cost inflation that will be passed on to Australians during the current cost-of-living crisis.

The Fuel Tax Credit Alliance includes the National Farmers Federation, Master Builders Australia, Minerals Council of Australia, Australian Energy Producers, Australian Grape and Wine, Seafood Industry Australia, Tourism Tropical North Queensland, Canegrowers, National Irrigators' Council, Victoria Tourism Industry Council and Maritime Industry Australia.

However, it is critically important to note the report was not commissioned by representative industry groups and organisations of agriculture, transport or tourism concerned with the potential impact of FTC reform on their respective industries, but was commissioned, and prepared solely for the use of the Minerals Council of Australia.

The Minerals Council of Australia represents 125+ firms in Australia's resources and fossil fuels sector, including the largest beneficiaries of the FTC Scheme in BHP, Rio Tinto, Glencore, Fortescue, Roy Hill, Yancoal Australia, Whitehaven Coal, Peabody Energy, and Anglo American. The Fuel Tax Credit Alliance is authorised by T. Constable, CEO of the Minerals Council of Australia.

[1] The Australian, Anthony Albanese Warned Over 'Economy-Wrecking' Greens Fuel Tax Credits Deal, 22 August 2024

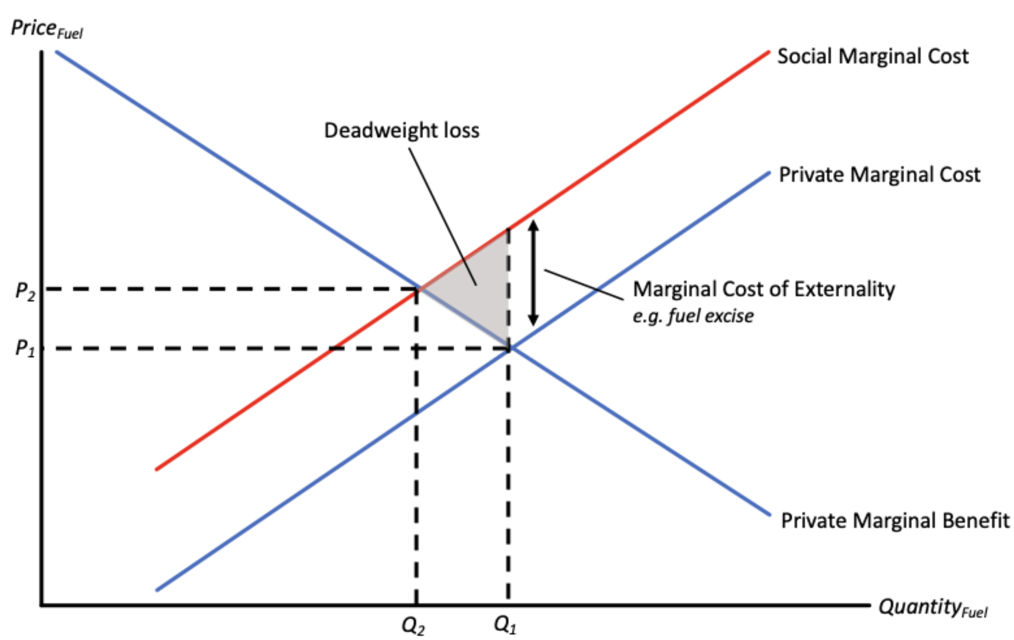
Firstly, the principal argument of the report is that the FTC Scheme is designed to finance road maintenance and expenditure in Australia, and thus, consumers of fossil fuels for use 'off-road', should be exempt from paying a tax designed to upkeep roads.

In September 2023 CEF published a report on the Fuel Tax Credit Scheme, in which this argument is debunked.[2] Since 1992, the Australian Government's capital allocation to road infrastructure has been **set independently** of fuel excise revenue. Ever since, fuel excise has been a general revenue-raising tax system, with the role of the fuel excise to contribute to the broader federal budget.[3] Federal road expenditure has **not followed movements** in fuel taxation since the introduction of the Fuel Tax Act 2006, the current legislation of the FTC Scheme.[4]

Furthermore, the report refers to the **user-pays principle**. Under the report's definition of user-pays principles, those who use a service are the ones who pay for that service, and thus, those that do not use a service should not be obligated to pay for it.[5]

However, the user-pays principle is the principle that all costs associated with the use of a resource should be included in the price of the goods and services that result from the use. Under the European Environment Agency's definition in relation to the consumption of natural resources, the user-pays principle calls upon the user of a natural resource to bear the cost of running down natural capital.[6]

<u>Figure: Economics of Negative Externalities in Fossil Fuel Consumption</u>



The exemption for large-scale industrial emitters to pay fuel excise acts as distortion to the economics of consuming fossil fuels, resulting in industrial industries paying the private marginal cost, rather than the true social cost. This social cost is then borne by individuals globally that pay for the impacts rapidly

[2] CEF, [Fuel Tax Credit Scheme and Heavy Haulage Electric Vehicle Manufacturing in Australia](), 11 September 2023
[3] Parliamentary Budget Office, [Fuel Taxation in Australia](), 21 September 2022
[4] Australia Parliament House, [Fuel Tax Act 2006](), 26 June 2006
[5] Rich Insight, [Assessing Fuel Tax Credits](), 19 August 2024
[6] European Environment Agency, [User-pays Principle]()

emerging from climate change, including diminishing crop yields, health care costs, skyrocketing insurance premiums from increasing severity and frequency of heat waves, floods, droughts, etc.

As the Minerals Council of Australia's commissioned report states: 'resultant uneven tax burdens create a range of unintended effects.' Unpriced negative externalities undermine zero emissions domestic alternatives and results in over consumption. Since FY2011, Australian fossil fuel imports have grown at a compound annual growth rate (CAGR) of 11%.[7] Western Australia, the economic powerhouse of Australia's resource exports industry, has seen emissions from the burning of fuels rise 47% compared to the 2005 baseline used for Australia's nationally determined contributions under the Paris Agreement. As a result, WA is the only energy- and industry-intensive state in Australia to have increased its total state emissions since 2005, rising 4%, compared to Queensland (down 29%), NSW (down 18%) and Victoria (down 32%).[8]

Reforming the FTC Scheme to internalise the negative externalities associated with the burning of fossil fuels, such that the entity responsible for the emissions pay, act as a Pigouvian/corrective measure to improve the efficient allocation of finite resources and align with our strategic national objectives.

Secondly, we view this report as misleading in its argument that the FTC Scheme is not a fossil fuel subsidy. As CEF and the Australia Institute[9] have previously published, the World Trade Organisation (WTO), of which Australia is a member, determines a subsidy to exist when, among other things, government revenue that is otherwise due is forgone or not collected (e.g. fiscal incentives such as **tax credits**).

In addition to the WTO, the Organisation for Economic Co-operation and Development (OECD), the International Energy Agency (IEA), the International Institute for Sustainable Development (IISD), Overseas Development International (ODI) and Oil Change International (OCI) all include Australia's FTC Scheme as a fossil fuel subsidy.

The existing legislation undermines Australia's credibility to decarbonisation by subsidising the costs of negative externalities, disproportionately benefitting Australia's largest mining companies. Despite the arguments that reforms to the FTC Scheme will wreak havoc on Australia's agriculture, tourism and transport industries, by far the biggest beneficiary of the FTC Scheme is Australia's mining industry, and has been well before the current iteration of diesel rebate mechanisms under the Fuel Tax Act. The mining industry accounted for 47% of all claims paid under the FTC Scheme in FY23.

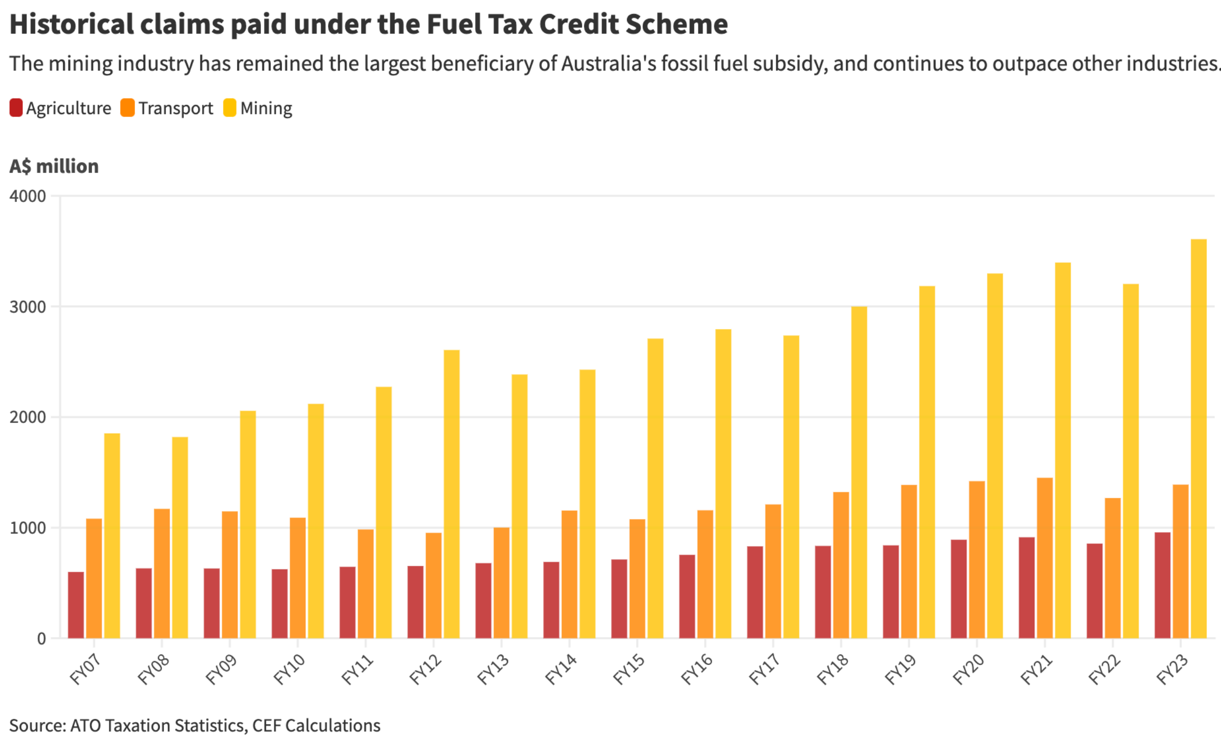
Australia's coal miners specifically, receive more tax credits than the nation's entire agriculture, forestry and fishing industries combined. The metal ore mining industry, of which is predominantly iron ore, receives more tax concessions than the entire road transport, postage and warehousing industries combined.[10] Since FY07 (introduction of the current FTC Scheme), fuel tax concessions to mining has grown at a CAGR of 4.3%, outpacing the average growth of all other industries at 2.7%.

The FTC Scheme also primarily provides concessions to large-scale, established miners, not small-to-medium enterprises (SMEs). Despite accounting for 47% of all fuel tax concessions provided in FY23, claims from the mining industry account for just 1.3% of all claims - 13 in every 1,000 claims.[11]

[7] CEF, Fuel Tax Credit Scheme and Heavy Haulage Electric Vehicle Manufacturing in Australia, 11 September 2023
[8] CEF, Superpowering-up: Accelerating the Electrification and Decarbonisation of the Pilbara, 13 August 2024
[9] Australia Institute, Australia's Fuel Tax Credits and the Debate over Fossil Fuel Subsidies, April 2024

[10] ATO, Taxation Statistics: Table 4 - Excise, updated 14 June 2024
[11] ATO, Taxation Statistics: Table 4 - Excise, updated 14 June 2024

Since FY07, the Federal Government has provided $103 billion in fuel tax concessions, of which, $45 billion has gone to Australia's miners, primarily to coal and iron ore conglomerates.



Capping the Fuel Tax Credit Scheme to Accelerate Decarbonisation and Electrification

CEF has proposed a reform to the existing FTC Scheme structure, calling for the introduction of a cap of $50 million per annum, per consolidated group.[12] Based on CEF's model, only 8 firms would have met the threshold in FY23: BHP, Rio Tinto, Fortescue, Hancock Prospecting, Glencore, Peabody Energy, Yancoal and Anglo American. As fuel excise is indexed biannually, it is likely a small number of firms would approach or exceed the threshold in the coming years, however **not a single firm** or entity operating in Australia's agricultural sector or road transport/freight would be affected.

This would ensure that the Minerals Council of Australia's, hiding behind the Fuel Tax Credit Alliance, concern that any reforms would wreck our economy through grocery price inflation and sky-rocketing input costs to transport during a cost-of-living crisis would be precisely zero. Problem solved.

Near 70 years of fossil fuel subsidies is long enough.

Based on the Federal Government's budget papers, the Australian Government has forecast from FY24 to FY27, over $18 billion will be paid to mining under the FTC Scheme, which extrapolated out to FY30, would result in a cumulative $37 billion in tax concessions from FY24. CEF's model identifies a cap of $50 million pa would result in over $14 billion in savings to the Federal budget over the same timeframe.

Given this measure would only affect the largest mobile fossil fuel consumers in Australia, CEF proposes 100% of the excess revenue generated from the tax credit cap be directed back straight to the firms impacted, so long as the proceeds are used to fund electrification and decarbonisation of Australia's resources sector.

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[12] CEF, Fuel Tax Credit Scheme and Heavy Haulage Electric Vehicle Manufacturing in Australia, 11 September 2023

This reform would instantaneously reshape one of Australia's worst climate and industry policies to become a major tailwind to electrification and accelerate the use of Australia's abundant and world-leading renewable energy resources to embed decarbonisation into value-added exports. A win-win-win, for the environment, for Australia's energy security and terms of trade, and for a future made in Australia.

The opportunity cost of inaction

The opportunity cost – the value of the next-best alternative when a decision is made, the forgone benefit that would have been derived from an option other than the one that was chosen – for continuing the public subsidisation of fossil fuels to our mining sector poses an immense risk to the future economic security and prosperity of Australia.

As CEF published in its latest submission to the Federal Government's consultation on unlocking green metals opportunities for a Future Made in Australia, onshoring a green iron industry is the top opportunity for our nation this decade.[13]

The success of the Future Made in Australia's re-industrialisation package will be the alignment of economic incentives with the broader national interest objectives of Australia. In addition to introducing support measures including an effective, and increasing price on carbon, production-based tax incentives, and contracts-for-difference for strategic metal and critical mineral refining, we must see reforms to outdated, fossil fuel propagating policies of yesteryear.

Adopting CEF's proposal above to reinvest 100% of the additional revenue gained from the cap provides a mechanism to enable the critical capital required to deploy the necessary renewable energy capacity, and scaling common user infrastructure and renewable energy industrial hubs to establish green metals precincts in strategic regions of Australia. Leveraging economies of scale, coordinated development, and reduced environmental assessment timelines through reduced proposals that currently are subject to significant backlogs and delays to the regulatory processes that already limit investment into renewables.

As highlighted in CEF's new report on the acceleration of electrification and decarbonisation of the Pilbara, the existing energy demand in the Pilbara would require over 16 terawatt-hours (TWh) of green electricity to decarbonise, equivalent to 7.8% of Australia's National Electricity Market (NEM).[14]

To efficiently, and cost-effectively build out the enabling infrastructure to decarbonise the largest user of diesel of Australia (metal ore mining), of which is primarily in the Pilbara, we must implement tailwinds to electrification, and remove headwinds to decarbonisation - subsidising diesel.

The world is in an energy system transformation race to the top, dominated by China's overwhelming cleantech leadership, as well as the US' Inflation Reduction Act, and significant policy packages to decarbonise in Japan and South Korea, of which China, Japan, and South Korea are our largest trading partners and export destinations.

If Australia's number 1 export commodity, iron ore, is to remain competitive in a global market increasingly impacted by re-industrialisation and protectionist policies of our trade partners, including the likely widening implementation of carbon pricing and carbon border adjustment mechanisms (CBAM), we must electrify and decarbonise at speed and scale. Australia will not capture the future value of a world-leading green iron and green metals industry without decoupling our climate and energy policies from the influence of multinational fossil fuel cartels, and their lobbyists.

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[13] CEF, Unlocking Green Metals Opportunities for a Future Made in Australia Submission, 14 July 2024
[14] CEF, Superpowering-up: Accelerating the Electrification and Decarbonisation of the Pilbara, 13 August 2024