

Improving carbon policy in Australia

Warwick J McKibbin

ANU Research School of Economics

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Overview

- What is needed in a climate policy?
- What would a future look like if all countries followed a globally efficient carbon policy?
- The government approach
- How robust is the policy?
- The Opposition approach
- How robust is the policy?
- What to do to fix the problem

What is Needed

- Long term carbon price
 - To drive innovation and investment
- A market to manage climate risk
 - To enable corporation and households to make long term decisions on carbon abatement
- A policy that does not violate comparative advantage – Australia has large endowments of low cost fossil fuel
- Policy should be robust to different futures

What might a globally efficient and equitable future look like?

- Only fossil fuels that were low cost and high value of output per unit of emissions would be burnt
- Due to endowments Australia would probably be the last place to burn carbon and most carbon intensive activities would be located in Australia
- The Australian energy system would be mostly coal and gas
- Renewables would not be a large part of the Australian energy system but would have niche markets where they are cost effective
- Australia would pay other countries to reduce a large proportion of emissions

The government policy

- A carbon tax at \$23 per ton in July 2012 rising to \$25.40 per ton in 2014-15
- Switch to a cap and trade carbon market in 2015
 - Price ceiling \$20 per ton above international price
 - with a floor price of \$15 per ton rising at 4% real per year and allowance for imported permits up to 50% of liabilities
- Large subsidies to renewables

What can go wrong?

- The world may not have an agreement so carbon credit that actually reduce emissions are not available
 - Carbon price would be very high in Australia given the target but global emissions would hardly change

What can go wrong?

- The world may have an agreement but the carbon price is less than \$15 per ton because of a global recession
 - Carbon price would drop from \$25.40 per ton to \$15 per ton in 2015 and many renewable investments would fail

What can go wrong?

- The world has an agreement and there is a global carbon markets.
 - Renewable targets drive energy prices up but Australia buys 50% of emissions from offshore and renewables don't penetrate the Australian market
 - Tens of billions of dollars of renewable funds have been wasted on infant industry arguments.

Outcome

- Enormous uncertainty in the return to long term investments in abatement activities
- Better to invest in lobbying for a policy change than to invest in reducing emissions

Other risks

- Compensation to households has been promised in dollars not permits
- Risks to the fiscal position have increased
 - Revenue depend on the actual carbon price
 - Compensation depends on the forecast carbon price

Problems with the government policy

- No long term carbon price
- No long term carbon market
- Exclusions reduce the coverage so costs higher than needed
- Increased uncertainty and greater risk in the fiscal balance

Opposition Policy

- Effectively the government pays for emissions reductions
- Plus subsidies to renewable energy
- Unlikely to reduce emissions at low cost because many low cost abatement activities not included.

Problems with the Opposition policy

- No long term carbon price
- No long term carbon market
- Exclusions reduce the coverage so costs higher than needed
- Increased uncertainty and greater risk in the fiscal balance

How to improve?

- Understand that the Kyoto world is no longer relevant
- Set longer term goals and issue permits with dates for that target
- Create a market to trade long term emission permits
- Keep all revenue in the market by using permits to compensate firms and households thus shielding the fiscal accounts
- Create a central bank of carbon to manage the short term carbon price (a tax in the short run).
- Don't allow imported permits except without clear compliance mechanisms and never for less than the price floor
- Drop subsidies and other distortions

How to improve both policies?

- Understand that climate policy is not about wedging the other side of politics nor about reducing emissions no matter what it costs.
- climate policy is about risk management and encouraging risk taking to reduce emissions at low cost so that investments in energy generation continue to sustain economic growth
- Long term policy requires a bipartisan agreement

Conclusion

- Many parts of the government climate policy look like the McKibbin Wilcoxon Hybrid approach but some key parts required for generating a long term carbon price are missing and can easily be incorporated.

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