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AUSTRALIAN CLIMATE CHANGE POLICIES IN 2016: FINDING THE BEST POLICIES TO MEET THE TARGET

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Key points

- For Australian domestic policy, the critical outcome of the COP21 Paris Conference was that the Government set a post-2020 emissions reduction target: 26-28 per cent below 2005 levels by 2030
- The Coalition Government's policies, even if on track to achieve the 2020 target, will need more work to achieve the post-2020 target and the Labor Opposition has yet to formulate its position.
- When political viability and public acceptability are added to criteria of credibility, flexibility, adaptability and low cost, none of the policy options as currently configured fulfils all the criteria.
- The task for government is to address the limitations of individual policies or find a combination that works.

The target


At December's international climate change conference in Paris, the world's governments' climate change aspiration increased: to hold the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5 °C. Participating countries, including Australia, have made national commitments to meet this objective. Recognising that the sum of these commitments falls short of the objective, a process was also agreed under which these commitments would be reviewed.

The immediate result is that Australia now has a target to reduce emissions to 26-28 per cent below 2005 levels by 2030 to add to its existing, unconditional commitment to a target of five per cent below 2000 levels by 2020. Recent Government projections indicate that the latter will be delivered. But meeting the 2030 target will be harder, and the lack of bipartisan support for how this might be done provides great uncertainty for investors when major investment in low-emissions technologies will be needed.

The 2016 domestic policy position

The Coalition Government has a suite of policy initiatives, including its \$2.5 billion emissions reduction fund and safeguard mechanism, which will be complemented by action on energy efficiency and vehicle emissions standards. The government has steadfastly rejected a comprehensive emissions trading scheme and the Minister for Environment has released emissions projections that indicate the current policy suite can meet the 2030 target.

The accuracy of emissions projections from both official and unofficial sources has been so poor over the last few years, that it is difficult to completely accept or reject this claim. However, such uncertainty does increase the value of a policy that links its operation and delivery directly with the emissions reduction target. There is correspondingly little value in a policy that depends on a forecast of future emissions that will inevitably be wrong.



The Labor Opposition is currently considering and consulting on the target that it will adopt, and the specific policies it will take to the next election. It remains committed to emissions trading and has an aspiration to deliver fifty per cent of electricity from renewable sources.

For industries characterised by multi-decade investment decisions, the absence of bipartisan consensus on even the central elements of climate change policy adds uncertainty and risk that will only increase as the need for new investment emerges in the coming years. Companies will not make long-term investments to reduce their emissions unless they are confident that policies are stable. To date, they have been anything but.

The challenge is to find a pathway to environmentally effective and economically efficient emissions reductions that is also politically deliverable over the longer term. As recently as 2009, there was clear evidence that agreement on the environmental and economic dimensions of this challenge was possible. In 2015/16, the political divide remains wide.


The 2016 domestic policy challenge

Australian climate change policy from 2009 to 2015 has been a fierce battleground with leaders on both sides of politics suffering major, in some cases fatal, damage. This background adds considerably to the challenge of developing credible and effective policy.

At one level, the task seems simple enough. The International Monetary Fund, the Organisation for Economic Co-operation and Development and the World Bank all consider putting a price on carbon “essential” to keeping the global temperature increase under two degrees. Yet, as Australian and international experience has shown, implementing such a price via a tax or trading scheme poses challenges. If these issues cannot be overcome, policymakers in Australia will need to look at alternative options for achieving reduction targets.

Governments have a number of policy options that might form part of an emissions reduction policy framework. Policies that reduce emissions may be a single mechanism to reduce emissions across the Australian economy, or a suite of policies, each targeting different sectors.

In mid-December, 2015, Grattan Institute released a working paper, *Post Paris: Australia's climate policy options*. This working paper sets out six policy options: a cap and trade emissions trading scheme; a carbon tax; an intensity baseline and credit emissions trading scheme; an emissions purchasing scheme; regulation; and a tradeable green certificate scheme. The challenge for policy makers is to develop a policy framework that meets several, sometimes conflicting criteria. A policy that may be ideal from a theoretical economic perspective, for instance, may be too complex to secure political or community support. The criteria are:

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- credibility: ability to meet the volume of emissions reductions required by current and future targets;
 - political viability: capacity to evolve from current policy settings and achieve bipartisan support;
 - flexibility: ability to adjust for changes in targets, political developments and technological change;
 - adaptability: potential to move towards an economy-wide market-based scheme over time;
 - public acceptability: ability to be understood and accepted by the community; and
 - low cost.

In addition to meeting these criteria, the success of any policy framework will depend on how it addresses three contentious design questions:

- How, if at all, will international permits contribute to Australia's emissions reduction goals?
- How will it deal with the issue of emissions-intensive, trade-exposed industries?
- What role will emissions offsets play?

There is no simple or perfect solution


None of the plausible policy options fulfils all of the criteria.

A cap and trade scheme meets many of the criteria - it is relatively easy to link a cap with an emissions reduction target and then expand in the future. Economists generally favour this approach to deliver lowest cost reductions. However, it is complex to design and this creates challenges in terms of political support and public acceptance, as happened in 2009 in the USA with the Waxman-Markey Bill and in Australia with Kevin Rudd's Carbon Pollution Reduction Scheme.

A carbon tax has the advantage of simplicity, and is likely to drive low cost emissions reduction. However, it can be difficult to set the tax level to deliver the desired emissions reduction and to establish a credible mechanism for future reviews. And carbon taxes, like cap and trade schemes, impose costs on businesses that pass these on to consumers through higher prices. The likely fatal flaw with a carbon tax is simply its name. This was illustrated starkly in 2013 when the Labor Government's fixed price on carbon provided a winning strategy for Tony Abbott. He successfully labelled it as a carbon tax thereby severely damaging Prime Minister Gillard's credibility.

Intensity baseline and credit schemes, like cap and trade and carbon taxes, have the advantage of delivering low cost emissions reduction through a market mechanism but with less impact on prices. This type of policy was successfully applied in New South Wales from 2003 to 2012. It could be effective in the electricity sector, but is harder to extend into sectors with more uniform emissions intensity.

The Federal Government has successfully applied an emissions purchasing scheme to deliver almost 100 million tonnes of reductions at a cost of around \$13 per tonne. Funding from the government's budget avoids direct price effects, but more stringent targets would require much bigger budget allocations, and this would likely become



problematic. Complementary policies, such as tightening the safeguards mechanism, will therefore be required.

Governments can directly regulate emissions reductions, an approach that the frustrated Obama administration has taken. Regulation can be effective in specific sectors like applying emissions standards to vehicles, but becomes onerous if used as an economy-wide policy. The cost of reducing emissions through regulation is also likely to be higher than under market mechanisms.

Finally, tradeable green certificate schemes have been applied to the electricity sector in the UK and many US states. In Australia, the Renewable Energy Target has delivered emissions reductions in, the absence of a carbon price, at a moderate cost of around \$40 per tonne. However it doesn't work as a broader policy.

The challenge to policy makers is complex and will be highly politicised. Stakeholders will offer solutions driven by a mix of sound analysis and vested interest. The task is to find solutions to the limitations of an individual policy, or to combine policies that collectively satisfy the criteria. A workable solution exists, but finding and delivering it will require effective and pragmatic compromise. For example, it may be possible to build an emissions trading scheme on the core of the current government's policies to meet the central principles of both the Government and the ALP.

ABOUT THE AUTHOR

Tony Wood is Energy Program Director at Grattan Institute, Australia's leading independent policy think tank.

He has been in this role since 2011, having previously been Director for Clean Energy Projects at the Clinton Foundation.

Tony held senior executive roles at Origin Energy for several years, and was seconded to advise the Garnaut Climate Change Review in 2008.