# Submission to the Inquiry into Carbon Pollution Reduction Scheme Legislation Exposure Drafts

Senate Standing Committee on Economics

## Public Submission by David T. Bath

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# Overview

I thank the Parliament and the Committee for the opportunity to comment on this important issue.

In my opinion, the bills have significant flaws, and I would urge members to reject the bills but for the recommendation by Ross Garnaut that the bills be passed now and remedied as soon as possible. The sole benefit of passing the Carbon Pollution Reducation Scheme (CPRS) bills is that they provide for some, albeit weak, diplomatic pressure on other nations, by creating a mechanism by which we can meet our international obligations (the first object of the main bill).

Perhaps the most telling criticism of the Carbon Pollution Reduction Scheme (CPRS) legislation is that the commentary on the exposure draft of the CPRS Bill 2009, while citing chapters 11 and 12 of the *"Garnaut Climate Change Review: Final Report"* (2008), does *not* cite the most relevant chapter of that report commissioned by the government: Chapter 14 *"An Australian Emissions Trading Scheme"*. The significant differences between the recommendations in the relevant chapter of the Garnaut Review and the current policy offerings from the government are deeply troubling.

I reluctantly support the passage of the bills, hopefully with significant improvements by the committee, and recognizing the need for many further initiatives to control carbon-equivalent emissions and mitigate the worst effects of the change, with these initiatives hopefully coming through the work of the Senate Select Committee on Climate Policy.

# Specifics of the Bills

## Australian Climate Change Regulatory Authority Bill

While the degree of independence of the Minister granted to the Authority is welcome, the eligibility requirements for members of the Authority suggest that the Authority will not be independent of sectional interests.

With the key objectives of monitoring the CPRS and other climate-related matters, providing a single authority for reporting and administration, there seems to be no importance placed on skills relating to climate and environmental modelling and forecasting, and no geosciences skills to audit sequestration reliability.

There does seem to be a bias towards membership (Section 18.2) by those who could be considered “lobbyists” for greenhouse gas polluters, putting “Dracula in charge of the blood bank” rather than merely allowing those sectors to make submissions to the Authority about the means of collection and appropriateness of the metrics they supply.

While experience in trading environmental instruments is a valid consideration for eligibility, given the tendency of markets to invent novel instruments without due consideration for stability and prudence, and given the current immaturity of markets for environmental instruments, it might be better to give more weight to a track record of predicting the market failures and weaknesses of instruments generally, thus qualifying economists who published grave concerns over instruments that have caused the general collapse of financial markets over recent times.

## Transnational Offsets

Ross Garnaut has commented publically that while transnational offsets and international emissions trading have a part to play, transnational offsets in countries with poor governance of emissions control and reporting should be extremely limited, if only because such offsets will be extremely difficult to audit.

This auditing of measures (such as not cutting down a forest) can be problematic, as there is no guarantee that those measures overseas are dependent on the actions of Australian companies.

Furthermore, the use of transnational offsets in developing nations is counterproductive to the Australian economy in the long term, as such offsets decrease the incentive to make the Australian economy (perhaps the world's worst per-capita carbon emitter) move to a low-carbon-emission state.

It may be simpler for the Australian government to bid for emissions permits from other governments under an appropriate international regime, and then make those permits available to the Australian market, thus providing equal access to international permits by all Australian companies, providing another policy lever through the ability to withhold or release those emissions permits to best effect.

## Free Permits

The insistence by the government on granting free credits to "trade-exposed" industries is extremely disappointing, and has already demonstrated the problems predicted by Garnaut in Section 14.3.1 of his report:

> "Free permit allocation would be highly complex, generate high transaction costs, and require value-based judgements regarding who is most deserving. ... This would involve introducing unavoidable arbitrariness.
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> "Agreeing principles of merit, collection and application of data, and resolution of disputes would be time-consuming. The complexity of the process, and the large amounts of money at stake, encourage pressure on government decision-making processes and the dissipation of economic value in non-productive rent-seeking behaviour.
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> "Free permits are not free. Although they may be allocated freely, their cost is borne elsewhere in the economy – typically by those who cannot pass on the costs to others (most notably, households."

It is noteworthy that the collapse of prices in the EU Carbon Trading Scheme (and the diminution of price signals that the CTS was designed to produce) is generally blamed on the allocation of free credits. In this case, the free credits were the result of pressure from individual EU member states and demonstrated a weakness of the central EU parliament compared to member states, whereas in Australia, the pressure for free credits comes from individual industry sectors, and shows an inexcusable weakness of the government compared to those industry sectors.

The argument for free permits put forward by those industry sectors is that they are "trade-exposed" to competitors from other nations that will not have emissions control schemes (whether by permits trading or simple carbon taxes).

To address the concerns of "trade-exposed" sectors, there are two complementary approaches:

The first can be implemented quickly and unilaterally, by "border adjustments", granting support to the trade-exposed *portion* of the output of carbon-intensive producers. Those products consumed domestically would receive no support, because there is no trade exposure. However, support might be given to that portion of output that is exported, taking into account any carbon tariffs by consumer nations on the products from nations without emissions control schemes, and the degree of competition from competitor nations with and without schemes. Such support is best given in a transparent and fungible manner, as simple cash grants rather than as free emissions permits.

These border adjustments could be implemented through the CPRS Excise and Customs bills.

The second approach is the development of an international convention for consumer nations to impose tariffs on the products of nations that do not have strong emissions control schemes, or take into account the strengths and weaknesses of those schemes. This has distinct advantages because it would simplify domestic adjustments, but would take some time and deft international negotiations.

Further, given the (disappointing low) minimal target of 5% reductions by 2020 from a 2000 baseline, an emissions scheme demanding 5% reduction should not require any free allocations or support to the trade-exposed portions of carbon-intensive sectors. Simple monitoring of emissions, with punitive and tough "make good" measures should suffice.

Indeed, this monitoring and enforcement approach should be more than adequate where the emissions reduction targets average less than 1% or 2% per annum – well within the efficiency gains expected of competent senior managers.

## Regulation of Environmental Instruments

As mentioned earlier, there is a risk from the development of new environmental instruments that can distort, if not collapse, the market in the same way the unregulated or "over-the-counter" instruments (e.g. CDSs and CDOs) ravaged financial sectors, and subsequently the real economy.

Australia, and indeed the world, cannot afford a similar disaster affecting environmental markets, and consequently the larger damage to the real world.

Therefore, extreme attention should be given to regulations for all environmental instruments, both domestic and international.

## Disincentives to State Governments, Households and Small Business

The key counter-productive effect of the CPRS is that is renders impotent any actions of state governments, individual households and small businesses to lower the carbon-equivalent emissions of the nation as a whole, either by energy-efficiency measures, or by introduction of low-carbon power-generation.

Under the scheme, the only mechanism states, individuals, and small businesses have to reduce emissions is to buy a permit and then rip it up.

This is one reason why the Swedish model of simple carbon tax at the point of production has been effective at reducing national emissions.

Short of the extremely complex approach of withdrawal of emissions permits taking into account energy efficiency gains (perhaps by calculating the efficiency gains of new flourescent or LED lights compared to former sales of incandescent bulbs, low-carbon power generation, drops in energy use for lighting and computing by companies), it is difficult to see how the counter-productive effects of the CPRS can be mitigated. Even then, this mitigation will be subject to perversion by arbitrary decisions and lobbying.

# Afterword

Given that the only equitable allocation of emissions targets to individual nations is largely based on per-capita emissions, and that Australia is among the very worst per-capita emitters (between 5 and 10 times as bad as China, and significantly worse than Western Europe), we will probably be subject to much greater pressure to reduce our per-capita emissions than any other nation.

It is not improbable that the change of emissions targets to an equitable per-capita basis could happen before 2020.

With this scenario, the CPRS will be woefully inadequate unless the government dramatically decreases the availability of permits each year and takes measures to avoid the pitfalls of unfair “hoarding”, or the entire CPRS is replaced by an emerging and tough international scheme.

Overall, the CPRS bills in their current form appear to have significant flaws, probably introduced by a combination of strong lobbying and weak government, ignoring the warnings by Garnaut in the introduction to Section 14.1 of his final report:

> “A principled approach is required if an emissions trading scheme is to be effective and efficient in supporting transition to a low-emissions economy.
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> …
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> “Conversely, a poorly designed scheme will compromise some or all of these outcomes; encourage and reward rent-seeking behaviour; delay at high cost the necessary structural adjustment; and raise the overall burden incurred by households.”

The requirement of government is to serve the people, the households, and ensure that the long-term well-being of all citizens is assured. This well-being is not well-served by supporting industries that will be as relevant to the coming low-emissions world as vellum production is in today's digital world.

As explained earlier, while many other carbon-efficiency measures (including destruction of permits) are necessary, and while there are many weaknesses in the current versions of CPRS bills, with appropriate improvements in committee and redrafting, I hope these bills are passed, and regulation of carbon emissions begin immediately rather than be delayed.