Australia

THE °CLIMATE GROUP

This is part of THE CLEAN REVOLUTION

The Clean Energy Plan - Update

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Context and Overview

Some four years after Kevin Rudd swept into office on a platform of strong action on climate change, the Gillard Labor Government's carbon pricing scheme has cleared its last hurdle. On November 8, 2011, the legislation passed through the Australian Senate and became law. From July 1, 2012 onward, emitting one ton of carbon dioxide will cost Australia's top 500 polluters AU$23.

Implementation of the carbon price may yet be eight months away, but increased policy certainty is already bringing change to the boardrooms and balance sheets of Australia's largest businesses. The 2011 Carbon Disclosure Report shows that the vast majority of Australia's largest businesses are now actively planning for a carbon-constrained economy.[1] Over the coming years, the carbon price is expected to unlock billions of dollars of previously blocked private investment in low carbon technologies and business practices.

This paper provides an update to The Climate Group's July 2011 Clean Energy Future Briefing Paper, covering the following issues:

1. How has the scheme changed since July 2011?
2. Amid concerns about the European emissions trading scheme, how will Australia's scheme compare internationally over the next few years?
3. What will Australia's key goals be in upcoming international negotiations at Durban COP17 and the Rio Earth Summit?
4. Is Coalition repeal of the carbon price legislation a realistic possibility?

[1] Carbon Disclosure Project (2011) 'CDP Australia and New Zealand Report 2011'. Available at: https://www.cdproject.net/CDPResults/CDP-2011-Australia-New-Zealand-Report.pdf

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1. Changes to the Clean Energy Future package

The Clean Energy Future Act passed on November 8, 2011 is very much the same complex set of compromises unveiled four months ago and examined in The Climate Group's July 2011 Clean Energy Plan briefing paper. There have been numerous changes to the legislation, but for the most part these have been technical and have not changed the actual effect of the scheme.

ETS opt-in rule

One significant modification, introduced in early September, was the provision of an 'opt-in' for major fuel users that may desire to participate in the ETS. The opt-in allows businesses such as airlines, miners and major transport companies to choose whether or not to be liable under in the ETS.

The change followed strong lobbying in favor of the opt-in by Virgin and Qantas. On the surface, lobbying for inclusion into the ETS may seem an unusual move for carbon-intensive industries. Looking deeper, however, the economic advantage becomes clear: the Clean Energy Future scheme had previously been designed to exclude some major fuel users from the ETS, but to effectively charge them the carbon price by increasing the fuel excise and reducing fuel tax credit schemes.

The preference for managing carbon liability through the ETS reflects a view that is dominant among economists and large businesses alike: market mechanisms are the cheapest tools for cutting carbon. As one Virgin spokesperson put it: "We welcome the opportunity to be able to opt in to the carbon pricing scheme, as it will enable us to source abatement measures at least cost."

Around 20 large Australian businesses are expected to find that opting in to the ETS gives them a commercial advantage.[2]

2. Going it alone? The international context of Australia's ETS

The Australian ETS debate has been highly sensitive to carbon pricing developments abroad, with Prime Minister Julia Gillard insisting that Australia will tread a careful, moderate line between climate laggard and climate leader. In this context, one of the most criticized elements of the ETS legislation was the set price of AU$23 per ton of carbon, amid fears it would prove excessive compared to international efforts. With a collapsing EU carbon price, these fears appear to have been founded; nevertheless, as explored below, international carbon pricing conditions are likely to look much more favourable on the short-medium term.

European carbon price collapse

The Clean Energy Future scheme is most frequently compared to the largest and most well-known of the globe's emissions trading schemes, the European Union (EU) ETS.

[2] Reuters (2011) 'Australia adds opt-in rule for polluters in CO2 scheme'. Available at: http://af.reuters.com/article/metalsNews/idAFL3E7KE15520110914

The EU ETS is presently recording some of its lowest-ever carbon prices, with the value of one ton of carbon dioxide recently falling below €10 (AU$13.5).

Ongoing concerns about unmanageable debt in weakened EU member states is dampening economic productivity in the wider Eurozone. The flow-on effect of lower economic growth is a reduction in the consumption of fossil fuels, making it easier for the EU to reach its carbon goals. This has caused a dramatic fall in the carbon price.

This sequence of events reflects the EU ETS working as it was intended: when the economy is performing well and can afford to pay for carbon mitigation, the price of emitting carbon will inflate; on the other hand, should there be an economic downturn then carbon prices will fall, cushioning the economy. A similar system will operate in Australia from July 2015 onward.

In the meantime, the large difference in Australian and EU carbon prices could place our high-carbon, trade-exposed industries at a disadvantage. However, the impact of this price difference is likely to be relatively small given the generous support schemes already offered to trade-exposed industries as part of the package. The impact on exporters is expected to be negligible in comparison to recent fluctuations in the value of the Australian dollar.

Lastly, it is crucial to remember that Europe has for some years now led the world with a carbon price, which at times peaked at over €33 (or AU$44). Studies of the European scheme over this period found that, despite its acting alone, the EU experienced industrial carbon leakage equal to less than 1% of its total emissions.[3]

Although the low EU carbon price will be politically painful for Labor on the short term, fears that Australia is 'going it alone' are likely to prove unfounded. The sub-€10 price is well below the marginal cost of abatement, and will increase on the medium term. Recent EU carbon price forecasts suggest that toward the end of 2012, the price should rise close to that set by the Australian Clean Energy Future package – at around €15.5 (or AU$21) per tonne of CO2.

Beyond the EU

Beyond the EU, a number of other carbon trading schemes are either underway or set to begin over the next one or two years.

- New Zealand already has a carbon price of NZ$25.00 in place, but businesses are permitted to submit one permit for every two tons emitted – effectively reducing the carbon price to NZ$12.50. A recent review proposed that the New Zealand carbon price cap rise by NZ$5 per year from 2013 onward, and the two-for-one allowance be removed in 2015.[4]

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[3] Carbon Trust (2009) 'Memorandum submitted by the Carbon Trust', submitted to UK Parliament. Available at: http://www.publications.parliament.uk/pa/cm200910/cmselect/cmenvaud/290/9042105.htm

[4] New Zealand Emissions Trading Scheme Review Panel (2011) 'Doing New Zealand's Fair Share', Ministry for the Environment, New Zealand. Available at: http://www.climatechange.govt.nz/emissions-trading-scheme/ets-review-2011/review-report.pdf

- California is also implementing a carbon trading scheme in 2013, with an average price of US$36 over the 2013-2020 period.[5] This will almost certainly be higher than the average Australian carbon price over the same period, given the Clean Energy Future package begins at just AU$23 and will be restricted by a price ceiling. With a population around 50% greater than that of Australia, California's ETS is expected to be the second largest following that in the EU in 2013.
- Chinese provinces may quickly steal second place off California in terms of ETS size, with six provinces to establish ETS pilot programs as early as 2013. The Chinese ETS program may cover some of the nation's most important industrial regions, with a total population of 250 million.[6]
- South Korea is developing its own carbon trading program with bipartisan support, and is on schedule to introduce such a scheme in 2015. The scheme is aimed to cut the nation's emissions 30% below expected business-as-usual levels in 2020.[7]
- South Africa is capping the missions of its top polluters, to achieve its aim for 34% emissions reductions by 2020. Businesses that exceed their emissions quotas face fines.[8]
- India has placed what effectively amounts as a carbon tax on coal. The tax is expected to raise US$555 million in 2011, much of which is will be used to aid the development of clean energy.[9]
- Japan is trialing an emissions trading scheme in Tokyo, a metropolitan region with a population of 35 million. The project aims to cut the city's emissions by 25% on 2000 levels by 2020.[10,11]

3. Australian carbon negotiations go global

If the four-year struggle to establish carbon pricing in Australia seemed demanding, the Labor Government now faces an even greater challenge: using Australia's newfound momentum to leverage increased action from the global community. Groundwork laid in the preceding months will be tested almost immediately at COP17 in Durban, beginning November 28 of 2011, and at the Rio Earth Summit that follows in June 2012.

Such negotiations will remain a core concern of the Labor Government over coming years. First and foremost, it is in Australia's long-term economic and environmental interests that international action is maintained at a level comparable to our own. For the Labor Government specifically, there will continue to be a link between support for its climate policies and the strength of international climate action. Beyond 2015, Australian governments must also manage the link between the Federal budget and international carbon prices.

[5] Point Carbon, (2011) 'California to give official kick off to carbon market'. Available at: http://www.pointcarbon.com/aboutus/pressroom/1.1635936
[6] ABC Lateline (2011) 'China closely monitors Australia's carbon policy'. Available at: http://www.abc.net.au/lateline/content/2011/s3314738.htm
[7] Cembureau (2011) 'South Korea sets -30% CO2 target for 2020'.
[8] Burger, A. (2011) 'South Africa enacts CO2 emissions cap', Triple Pundit. Available at: http://www.triplepundit.com/2011/10/south-africa-enacts-co2-emissions-cap-climate-negotiators-converge-durban/
[9] Pearson, N. (2011) 'India $555 million coal tax may fund electricity lines', Bloomberg.
[10] Point Carbon (2011) 'Over 300 offset projects seek Tokyo ETS approval'. Available at: http://www.pointcarbon.com/news/1.1656729.
[11] Fox, B. (2011) 'Asian cities as low carbon catalysts', East Asia Forum. Available at: http://www.eastasiaforum.org/2011/04/02/asian-cities-as-low-carbon-catalysts/

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The Australia-Norway climate roadmap

Australia is not wasting any time. In a submission to the UNFCCC process, Australia and Norway have proposed a new roadmap for international climate negotiations, including proposed outcomes for Durban. The roadmap has already garnered tentative but wide support among developed nations, but is still being contested by developing nations that prefer ongoing commitment to the Kyoto Protocol.

The Australia-Norway roadmap calls for the 2011-2014 period to establish carbon accounting rules, international oversight procedures, and the scaling-up of mitigation ambition in order to meet the 2°C warming goal agreed to at the end of COP16 in Cancun. Work to embed such mitigation targets into a new legally binding protocol would take place in 2015.[12]

Building the international carbon market

A longer-term challenge for Australian negotiators is preparing for the linkage between the Clean Energy Future ETS and other ETS programs internationally. Linkages with New Zealand and the EU are likely to be the first to go ahead, following Australia's transition to a floating carbon price in July 2015.

A number of difficult obstacles remain. Most obvious are each nations' different attitudes to price control: Australia in particular has been cautious to curb the possibility of very high carbon prices. When the Australian carbon price is floated, its movements will be restricted by a price floor and ceiling. Moreover, sale/export of Australian permits overseas will be banned, to prevent the supply of domestic permits contracting sharply and raising the price.

The EU, however, has rejected price collars, limiting the range at which EU and Australian carbon prices can find parity. Australia's price collars and permit export restrictions are currently scheduled to be removed in July 2018, but the opportunity to accelerate integration may see these scrapped at an earlier date.[13,14]

Another controversial area is the CDM, with debates around its role mounting in their political complexity as the expiration date of the Kyoto period approaches. From July 2015 onward, the CDM is intended to be a major source of certified international offsets for Australia's ETS. Japan, however, has recently sidestepped the CDM, adopting its preferred approach of engaging bilaterally with developing nations to support carbon-cutting projects.[15] Other nations are frustrated that CDM projects have been heavily

[12] Australia & Norway (2011) 'Submission under the Cancun Agreements', UNFCC. Available at: http://unfccc.int/files/meetings/ad_hoc_working_groups/lca/application/pdf/australia_norway_mitigation_submission_.pdf
[13] Australian Government (2011) 'International linking', Australian Government, Canberra. Available at: http://www.cleanenergyfuture.gov.au/international-linking/
[14] Jotzo, F. & Betz, R. (2009) 'Linking the Australian ETS', Crawford School of Economics, ANU. http://www.crawford.anu.edu.au/research_units/eerh/pdf/EERH_RR14.pdf
[15] Parkinson, G. (2011) 'Now for the really hard climate talks', Climate Spectator. Available at: http://www.climatespectator.com.au/commentary/now-really-hard-climate-talks

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focused in China and India, at the expense of least developed nations.[16] Reaffirming the role of the CDM in a post-Kyoto world will be a key Australian goal at Durban.

4. Testing the pledge: Can the Coalition repeal the carbon price?

Anti-ETS rhetoric reached new heights in the weeks prior to its passage in the Senate, with the leader of the Coalition, Tony Abbott, swearing a 'blood pledge' to repeal the legislation. Close scrutiny of the pledge by legal, political and business analysts suggests that attempts to repeal the legislation would face immense barriers.

Legal barriers to repeal

The first legal barrier facing the Coalition is constitutional structure of the Senate: only half the Senate is re-elected every three years. Given today's balance of power is firmly in the hands of the Greens, the Coalition would require a historically unprecedented landslide to gain Senate control in 2013.

In response, the Coalition may choose to instigate a double-dissolution election. A double-dissolution, however, will only become possible if the repeal legislation is rejected by the Senate twice. After the new senators take office in July 1, 2014 and, hypothetically, the repeal is first rejected, the Coalition will need to wait three months before re-submitting the repeal. Add to this the inevitable slowing of the process through Senate inquiries, and the closest possible date for a double-dissolution is in early 2015.

Second, it is controversial as to whether permits can legally be 'ripped up' or whether they are property to be acquired under 'just terms'. As a constitutional issue, the outcome of such a question can only be determined by the High Court – unlike the Malaysia solution, the result cannot be altered by acts of legislation. The risk of failure in the High Court, and the immense compensation claims that would follow, is likely to inhibit attempts to repeal the legislation.

Political barriers to repeal

Maintaining present levels of public antipathy towards carbon pricing for more than three years is a challenging prospect for the Coalition. Three years is a long time in politics, and present trends do not provide much comfort for those interested in repeal. The crucial factors over the coming years include:

- By late 2012, the relatively minor inflationary impacts of the price will have been directly experienced by the community, in parallel with the compensation package.
- Should the Coalition repeal the carbon price legislation, it will face an immense gap in the budget. The only obvious ways to fill this gap are income taxation with major cuts to social services – both politically unpalatable options.

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[16] Welton, S. (2011) 'The Clean Development Mechanism continues to be plagued by uncertainties over past performance and future role', Columbia Climate Law Blog. Available at: http://blogs.law.columbia.edu/climatechange/2011/10/24/the-clean-development-mechanism-continues-to-be-plagued-by-uncertainties-over-past-performance-and-future-role/

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- Mounting international implementation of carbon pricing will soon give the sense of the 'winning side of history'. The introduction of a floating price in 2015 will bring the Australian scheme into further alignment with international ETS programs, and will make use of the word 'tax' obsolete.
- Coming up to 2020, with climate change impacts mounting and national emissions targets approaching, it is difficult to imagine a world where international carbon markets are not the norm. With the increasing sense that carbon pricing is inevitable, orchestrating a costly repeal will be a clear waste of public money and political capital.
- In the meantime, prolonged uncertainty is likely to increase calls for bipartisanship on carbon pricing. Already numerous companies are expressing concern about the effect of potential repeal upon long-term investment certainty.[17] By 2015 it is likely that a number of large businesses will have made significant investment decisions based upon the expectation of a carbon constrained economy. This would make for a very different business landscape to the one the Coalition has courted in 2011.
- Finally, the Coalition is split down the middle over climate change. In the midst of declining support for Tony Abbott, transition to the next most popular Liberal candidate—Malcolm Turnbull—would immediately bring bipartisan support for carbon pricing in Australia.

Impacts of the pledge

Though the repeal is unlikely to take place, the strength of the Coalition's position will negatively impact investor assessments of Australian sovereign risk. Henry Derwent, CEO of the International Emissions Trading Association, said the 'pledge' would cause confusion for those looking to invest on Australian shores, and that investors "will be cautious about dealing with Australia".[18]

While instability in Canberra will cause short-term confusion for investors, long-term certainty in carbon pricing legislation will be determined more by the business community than by any other factor. Once a tipping point of business investment in carbon markets is reached, it will be too politically and economically damaging to repeal the legislation. Markets will reflect this reality by confidently factoring the carbon price into all long-term decisions.

Early signs indicate that the business community is beginning to commit. The Businesses for a Clean Economy (B4CE) coalition of 330 businesses, for example, welcomed the carbon price by stating that: "Businesses are poised to invest and innovate and the carbon price package will support progressive businesses to start taking immediate action." And the 2011 Carbon Disclosure Report has revealed that Australia's largest businesses are rapidly taking up the challenge of competing around carbon emissions: more than half of the ASX100 has set emissions reduction targets, a 15 % rise in the number of businesses compared to 2010 levels.[19]

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[17] Macdonald-Smith, A. & Williams, P. (2011) 'Abbott's stand sparks power price anger', Australian Financial Review.
[18] Parkinson, G. (2011) 'Now for the really hard climate talks', Climate Spectator. Available at: http://www.climatespectator.com.au/commentary/now-really-hard-climate-talks
[19] Carbon Disclosure Project (2011) 'CDP Australia and New Zealand Report 2011'. Available at: https://www.cdproject.net/CDPResults/CDP-2011-Australia-New-Zealand-Report.pdf

As the Clean Revolution mounts among Australian businesses and the wider international community, today's political battles—and the impact of the repeal pledge—are likely to become a distant concern. Ideally, this decade will see climate politics turn to constructive debates around our level of ambition in clean technology, the role of complementary measures alongside the carbon price, and how to integrate Australia's Clean Revolution with that of the wider world.

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