The Australia Institute

Research that matters.

The direct costs of waiting for direct action

Policy Brief No. 30
August 2011
ISSN 1836-9014

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TAI

Policy Brief

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About TAI

The Australia Institute is an independent public policy think tank based in Canberra. It is funded by donations from philanthropic trusts and individuals, memberships and commissioned research. Since its launch in 1994, the Institute has carried out highly influential research on a broad range of economic, social and environmental issues.

Our philosophy

As we begin the 21st century, new dilemmas confront our society and our planet. Unprecedented levels of consumption co-exist with extreme poverty. Through new technology we are more connected than we have ever been, yet civic engagement is declining. Environmental neglect continues despite heightened ecological awareness. A better balance is urgently needed.

The Australia Institute's directors, staff and supporters represent a broad range of views and priorities. What unites us is a belief that through a combination of research and creativity we can promote new solutions and ways of thinking.

Our purpose—'Research that matters'

The Institute aims to foster informed debate about our culture, our economy and our environment and bring greater accountability to the democratic process. Our goal is to gather, interpret and communicate evidence in order to both diagnose the problems we face and propose new solutions to tackle them.

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The direct costs of waiting for direct action

In 1990 the Liberal Party under Andrew Peacock committed to a greenhouse gas emissions reduction target. Two decades later Australia is only now preparing to take serious action to reduce emissions. As the costs of climate change have emerged and it has become increasingly clear that we need to take action, business has called for certainty from the Government. The uncertainty being created because Australia does not have a mechanism in place to reduce emissions means that firms are being forced to put off investment decisions. This inaction has a cost and is leading to inefficient, expensive stop gap measures being implemented by business in their wait for real action. The longer the uncertainty the greater the cost will be.

The Liberal Party is generally seen as a supporter of business and business certainty. In 2009 the current leader of the Liberal Party, Tony Abbott was concerned about the uncertainty created by the issue of climate change. When talking about policies to combat climate change he said: “Before making investment decisions, businesses want to minimise uncertainty.”[1] Business has been calling for certainty on carbon policies to allow them to make investment decisions for a long period of time.[2] The Labor Party has also made it clear that it is concerned about the level of uncertainty that the issue of climate change has created for business.[3] With all the agreement on the importance of business certainty, why do we have so much uncertainty on carbon policies?

How did it come to this?

In the 2007 federal election both major parties committed to introducing an Emissions Trading Scheme (ETS). By 2009 both parties agreed on an emissions reduction target of five per cent on 2000 levels by 2020. But since Tony Abbott became leader of the Liberal Party the bipartisan position for a reliance on a market based mechanism to reduce Australia’s carbon emissions has broken down.

While the Coalition remains committed to the same target as the Government it now proposes to meet that target with a competitive grant scheme which it calls the Direct Action Plan and in turn oppose all forms of market based carbon pricing including the Labor Party’s proposed carbon tax that converts into an ETS after three years.

The Coalition is doing more than campaigning against a carbon price. It is the job of an Opposition to be critical of Government policies they disagree with but the Coalition has decided to go much further than critique in committing to ‘roll back’ the carbon price should they form government[4]. This commitment creates uncertainty in the business community since even if the carbon price passes Parliament it does not resolve the issue and may be subject to a roll back at a later date. Furthermore, the Coalition has also committed to a double dissolution election if it wins government but cannot pass its legislation to roll back the carbon price. This will create even more uncertainty.

The impact of roll back on business certainty

The commitment to roll back the carbon price made by the Coalition will destroy some of the certainty the introduction of a carbon price could provide to Australian investors. If there is a

[1] http://www.tonyabbott.com.au/News/tabid/94/articleType/ArticleView/articleId/7087/A-REALISTS-APPROACH-TO-CLIMATE-CHANGE.aspx

[2] http://www.abc.net.au/news/2011-05-16/business-seeks-certainty-on-carbon-tax/2694722

[3] http://www.alp.org.au/federal-government/news/speech--julia-gillard,--moving-forward-together-on/

[4] http://www.smh.com.au/environment/business-demands-certainty-on-carbon-20110228-1bbs2.html

reasonable chance that the carbon price can be rolled back in the future then firms are unlikely to risk making long term investment decisions that are exposed to a carbon price. The longer the period of uncertainty is then the larger the cost to the economy will be. In its 'Red Book' advice to the incoming government in 2010, Treasury wrote: "There are also real and present costs associated with ongoing uncertainty around the climate change policy framework, particularly in the electricity generation sector."[5]

If we assume that the Coalition will continue with its commitment to roll back the carbon price then we can estimate the period of uncertainty this will create. This is spelt out in detail in Figure 1.

The timeline

The most likely outcome at the moment is that the carbon price legislation will pass towards the end of 2011 and the carbon price will start in July 2012. The next federal election is likely to take place in late 2013. If the Coalition commits to rolling back the carbon price and it wins the 2013 election then they are likely to introduce legislation for the roll back and its replacement with the Direct Action Plan by mid 2014. The Coalition is unlikely to win a majority in both Houses of Parliament so it is likely that the Labor Party and the Greens will combine in the Senate to block the legislation they have worked hard to introduce. The Coalition, if it planned to use the issue as a double dissolution trigger, would need to wait for the new Senate to sit in mid 2014 before submitting the legislation. In such a situation Tony Abbott would likely have committed to reintroducing the legislation which they could do by early 2015. If it was blocked a second time and the Coalition called a double dissolution on the issue then we would likely have an election in mid 2015. If we assume that the Coalition wins enough seats to pass the legislation then we can expect the roll back and Direct Action Plan to start by mid 2016.

If the Direct Action Plan starts in 2016 that does not mean that emission reduction projects will begin immediately. A large number of public servants would need to be hired for the administration of the scheme. There will need to be a call for tenders and time will need to be given for firms to fill out forms and supply all necessary information required for the accountable expenditure of public money. All the tenders will need to be assessed by the newly hired public servants. When the successful tenders have been selected, cheques will be posted to the winning bidders. The winning bidders will then need to hire experts and builders to implement their emissions reduction projects, at the same time as all the other successful applicants. It will likely be 2018 before emission reduction actually begins. This is just two years before the emissions reduction target is due to be reached.

As shown in Figure 1 it would seem highly likely that if the Coalition stays committed to rolling back the carbon price and they have the support of the Australian population for this then it will be 2016 before we have certainty on an outcome and 2018 before actual abatement projects begin. That is, we will continue to have a high degree of uncertainty and the associated costs to the economy that will bring for at least another five years.

Unfortunately the period of uncertainty is likely to be even longer due to the fact that the Opposition has not ruled out introducing a price on carbon in the medium term. Indeed in December 2010 the Opposition Environment spokesman Greg Hunt said that the Coalition would use government grants to reduce emissions in the "first instance" but after 2015 left open the possibility of a carbon price.[6] This creates the possibility that shortly after rolling back the Labor Party's carbon price and introducing their Direct Action Plan the Coalition will

[5] http://www.treasury.gov.au/documents/1875/PDF/01_Overview.pdf

[6] http://www.smh.com.au/opinion/politics/so-much-hot-air-and-its-not-all-the-climates-fault-20110304-1bhrl.html

potentially abolish their Direct Action Plan and introduce a carbon price. This of course will create more uncertainty.

The costs of uncertainty

In business uncertainty has a cost. The more uncertain the return on an investment is the higher the rate of return has to be to induce a firm to make the investment. That is, the old adage of the link between risk and return very much applies to commercial investment in energy intensive industries. This means that uncertainty reduces the likelihood that firms will invest and increases the profit margin and market price required by those that do. In the case of uncertainty about a carbon price this could result in not only reduced investment in low carbon emissions technology but also in carbon intensive technology. Take for example electricity generation. A firm is deciding between a lower emissions gas fired power station or a higher emissions black coal fired power station. Under a carbon price the coal fired power station is uneconomical because of its higher emissions. Without a carbon price the gas fired power station is uneconomical because the cost to generate electricity from gas is higher than electricity generated from coal. Without certainty the firm is likely to simply make the decision to build neither power station. This could then push up electricity prices and reduce security of power supply.

The Investor Group on Climate Change, which represents all the major funds managers in Australia and more than half of the superannuation money invested in the country, commissioned a report from SKM/MMA to analyse what would happen if a carbon price was introduced in 2016 rather than 2012.[7] The report found that without carbon price certainty power generators would meet the short fall in power generation by building open cycle gas plants (OCGT) which are cheaper to build but less efficient (and more emissions intensive) than combined cycle gas plants (CCGT) which are more efficient but more expensive to build. This would push up the price of electricity and reduce the competitiveness of the businesses the Opposition says it is so concerned with. The report found that the uncertainty would add an additional $2 billion in costs and increase electricity prices by 20 per cent.

As the length of time around the uncertainty grows, so does the cost. If the Coalition pursues its current commitment to roll back the carbon price this could lead to five or more years of uncertainty followed by more uncertainty on a post 2020 emissions reduction mechanism. If the Coalition is planning on rolling back the carbon price it needs to be up front about how long this process will take and what policies they are going to put in place to mitigate the costs that businesses are going to face because of the prolonged period of uncertainty. The Coalition also needs to be clearer about its post 2020 emissions reduction policy and what type of emissions reduction mechanism it intends to implement after the 'interim' Direct Action Plan. Australian businesses need to know what action is going to be taken on climate change so they can make the investment decisions that will reduce Australia's emissions and grow the economy.

[7] http://www.csf.com.au/external/documents/IGCC_CS_report_June2011.pdf

2011: Carbon Price Legislation Passes Parliament

Late 2011
- Coalition decides to campaign to roll back Carbon price.

IF NOT, THEN BUSINESS CERTAINTY.

Mid 2012
- Carbon price starts

- Coalition persists with campaign to roll back Carbon price

Late 2013
- Coalition wins federal election

IF NOT, THEN BUSINESS CERTAINTY.

- Coalition persists with roll back of Carbon Price

IF NOT, THEN BUSINESS CERTAINTY.

Late 2014
- Coalition submits roll back legislation and Direct Action Plan. Senate defeats legislation.

IF NOT, THEN BUSINESS CERTAINTY.

Early2015
- Coalition waits 3 months and then resubmits legislation

- Legislation is defeated a second time

IF NOT, THEN BUSINESS CERTAINTY.

- Coalition decides to call double dissolution election

Mid 2015
- Double dissolution election held

IF NOT, THEN BUSINESS CERTAINTY.

- Coalition wins enough seats to pass legislation in joint sitting

IF NOT, THEN BUSINESS CERTAINTY.

Mid 2016

- Carbon price ends and Direct Action Plan begins

Late 2016

- Grant applications sent out

Early 2017

- Grant applications filled out and returned by tender's

Late 2017

- Grant applications assessed

Early 2018

- Winning applications announced and cheques sent out

Mid 2018

- First Direct Action Projects commence

2020: Two years later Direct Action Plan ends. The post 2020 target requires a carbon price. Government of the day introduces carbon price with bipartisan support.