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Let's not Blow the Budget on Direct Action

Ross Garnaut

I appreciate the Environment Minister Greg Hunt responding "in the spirit of robust debate" to my evidence to the Senate committee on Direct Action (*AFR*, March 17).

This is written in that spirit because the publication of the green paper on the Emissions Reduction Fund allows discussion to start of the government's alternative to established policies.

The minister contrasts the established law's carbon tax approach with direct purchases of abatement, which is "the basis of the largest abatement system in the world – the United Nations' Clean Development Mechanism (CDM)".

I know the CDM, having been a member of the United Nations panel that reviewed the operation of the system and made recommendations for its reform in 2012. The CDM reduces the cost for developed countries to meet their own emissions targets by paying for developing countries to reduce their emissions in specified ways. The purchase of CDM credits does not reduce global emissions.

The minister says the Emissions Reduction Fund (ERF) is "similar to the former government's non-Kyoto carbon farming fund which Professor Garnaut supported". I support, and helped to develop, the Carbon Farming Initiative (CFI). I am pleased the government plans to continue it.

The CFI works because credits generated by farmers can be sold to enterprises which have obligations to acquit permits within the carbon pricing arrangements. It provides an alternative and lower cost way for businesses to meet carbon price obligations.

The CDM and the CFI depend on some external entities being required to meet a firm cap on emissions. So far as one can tell from the green paper, the Emissions Reduction Fund doesn't work like that. While any farmer now who is able to generate certified reductions of emissions can sell these credits at the carbon price (marginally less, to provide some incentive for the buyer and for any intermediaries in the transaction), under Direct Action the farmer will only be paid for her credits if she wins the reverse auction.

RULES OF REVERSE AUCTION

The farmer will have to invest in preparation of a proposal for emissions reduction and take her chances with the auction. No payments will be made and the investment in preparation of bids will be lost unless she wins the reverse auction. The price paid to winners of the reverse auction will be lower than current prices paid to CFI farmers unless the amount put aside for purchases is much larger than envisaged in the forward estimates. There will be fewer CFI credits generated under Direct Action as described by the green paper than under the established carbon pricing.

Without all businesses being subject to an emissions cap and to penalties for breach of the cap, the purchases of the ERF may be swamped by increased emissions elsewhere. That is one of four reasons why the estimate of $4 billion to $5 billion per annum that I presented to the Senate committee for the likely increase in the budget deficit associated with meeting a 5 per cent emissions reduction target by Direct Action rather than established policies is a lower limit. The budget blowout would increase to the extent that other entities increase emissions (as they are bound to do without baselines and penalties); that Australia’s international commitments require us to meet stronger targets (as they already do); that it turns out to be more expensive to meet our obligations entirely at home rather than partly through buying abatement abroad (as it clearly would); and that any weakening of other established policies for emissions reduction (for example, the renewable energy target) would increase the “business as usual” emissions which would have to be counteracted by purchases from the ERF.

Mr Hunt does not contest my lower bound estimate of the deterioration of the budget deficit associated with the shift to Direct Action. He says the established carbon pricing involves “taxing 100 per cent of enterprises into submission when you can just buy back five”. No firms are taxed into submission. Trade-exposed emissions-intensive enterprises receive free permits which they are able to sell if they reduce emissions, as Alcoa’s accounts suggest it has been able to do. Liable firms selling into the home market are all treated the same way, pass on the costs to users, and households are compensated for increased costs through tax cuts and adjustments to social security. The consistency of the increases in consumer prices with the estimates provided from Treasury modelling show these assessments are soundly based.

The minister says the carbon tax doesn’t reduce emissions. That is wrong. Firms liable for carbon pricing have substantially reduced emissions, and carbon pricing and other established policies have changed dramatically the Australian tendency for emissions to rise strongly in times of economic growth.

Mr Hunt’s willingness to engage in debate is welcome. If Australia is to do its fair share in the global climate change mitigation effort, without blowing the budget and introducing intrusive discretionary intervention into the affairs of individual enterprises, this debate must continue.

It is important that it continues until Australians’ representatives in the Senate know as much about the strengths and weaknesses of Direct Action as they have had the opportunity to know about established policies.