

## RECENT DEVELOPMENTS: June 2009

### **Australia's Problematic ETS**

In an era when public support for 'doing something' about climate change is at an all-time high, Australia's effort to enact a greenhouse gas emissions trading scheme (ETS) has been deferred by the Senate of the Australian Parliament.

It may seem paradoxical but the problem is one of the Government's own making.

### **Acting in Too Much Haste**

After the Rudd Government was elected in November 2007, it made up for lost time by ratifying the Kyoto Protocol and commissioning an independent climate change policy review by Professor Ross Garnaut.

The Garnaut Review represented a major intellectual effort. Its draft findings in July 2008 created a degree of consensus amongst the business and the general community.

To that point, all praise to the Government.

The Government would have been well advised to let the debate run on by itself, wait for the final Garnaut report in September 2008 and allow the public to develop an informed appreciation of the costs and benefits of the recommendations that the report put forward.

Instead, within 12 days of the draft Garnaut report, the Government rushed out with a Green Paper on what it termed a Carbon Pollution Reduction Scheme (CPRS). The Green Paper outlined the Government's preferred position on all issues and asked for submissions.

In signalling significant economic reform, this over-hasty initiative had the very opposite effect to what might have been the case. Instead of building on an emerging consensus, it created argument and polarised many stakeholders who felt their concerns would not be taken into account.

### **Was the Market Ever to Blame?**

At the time of launching the CPRS, the Prime Minister seized the moral high ground:

*"By making the cost of carbon pollution visible, we will begin to redress what Nicholas Stern rightly described in 2006 as the greatest market failure in history."*

A pious gibe.

It is patently wrong to imply that industrialisation constitutes market failure. Without engines and electric power, there would be no radio, no telephone, no computers and no internet. We would still have the wheel and the compass but not many of the other benefits that modern industrial society provides.

If this was really a case of market failure, there would be a case for government intervention to remedy the failure. Instead, governments have set about creating independent markets in artificially-contrived emission permits – markets that are characterised by the risk of government readjustment and intervention. There is a role for an ETS but it is vital for consumers that energy markets should continue to function freely and efficiently.

### **Climate Change Politics**

In Australia, climate change politics and misplaced optimism about the environmental effectiveness of the CPRS have largely overtaken reason. The Government's zealotry in pushing the CPRS has had less to do with saving the Great Barrier Reef and more to do with fracturing the Opposition for questioning the design of the Government's scheme.

If Australia's dependence on fossil fuels could be reduced overnight, it would make no difference to the global climate without concerted action by other countries, especially the US, China and India. The link between the aim of the CPRS (a reduction in Australia's domestic emission levels) and a reduction in global emission levels, sufficient to have a perceptible effect on climate change, remains tenuous.

## **Uncertainty for Investors**

The Government also severely underestimated the impact of the CPRS on investors. The impact on the international competitiveness of Australia's export industries, despite the Government's offer of 'transitional assistance', made many investors unsure of the viability of both existing and prospective investments.

The CPRS legislation gave power to the Minister to set future emissions caps, posing greater regulatory risk than other emissions trading schemes proposed or operating elsewhere in the world. No amount of computer modelling about the affordability of the scheme could alleviate the concern that the Minister might have power to push up the price to unaffordable levels by cutting down the future supply of permits. Many saw this as an unacceptable risk.

The apparent rationale for the Government's position was that the international climate negotiations would result in a global price for carbon that would alleviate industry's concerns.

## **Unnecessary Friction**

Much unnecessary friction in Australia arose from claims that the issue of free permits would make the CPRS environmentally ineffective. Similar claims in the US have not prevented the progress of the Waxman-Markey Clean Energy Bill through the US Congress. As the Pew Center emphasised this month:

*"The cap in a "cap-and-trade" system determines its environmental stringency by setting the number of emission allowances that are available. These allowances are equal to the amount of emissions that are permitted under the cap and their number declines over time as the cap is tightened. From an environmental perspective, it doesn't matter how the emission allowances are distributed. They could be auctioned or freely distributed or any combination of the two."*

## **Who is Really to Blame for Climate Change?**

A way of answering this question is to ask: what is the real problem? The problem is nothing to do with climate science – the problem is the lack of presently-affordable technology to reduce carbon intensity in the energy and transportation industries. This is a problem largely of money.

Who can be blamed for this state of affairs? Certainly not the market. It must have been someone else and, whoever they are, they must be from the South as well as the North.

Could it have been whoever set the standards? Could it have been governments? Could policy failure have played any part in this?

## **What Governments Could Be Doing About the Real Problem**

Current climate policy remedies are too remote from the real problem of how to make energy use less carbon-intensive.

Governments should agree on international standards for discharge of greenhouse gases; governments should provide greater financial incentives for research and development of low-carbon technologies that will comply with international standards.

Sector-specific agreements to set international standards should be considered. You can start with primary fuel production, such as LNG, proceed to conversion of primary to secondary energy (electricity and steam), move on to transportation and distribution and finish off at the point of use.

This can be done either with or without an international agreement in Copenhagen on economy-wide emission caps for the wealthy countries that account for less than half of global emissions anyway.

## **What Will Happen Next?**

It seems likely that Australia's problematic ETS will not pass into law in time for the international climate negotiations in Copenhagen and that some further reflection and re-design will be needed.

This should result in a better scheme than first proposed, one that may be less damaging to Australia's export industries.

## **Further Information**

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