

Australia's Carbon Tax Experience

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Policy Design

- The supporters of Australia's approach:
 - “An imperfect carbon policy in the short run is better than no short run policy – it can be fixed over time”
- My View:
 - “A flawed short run policy will destroy effective long run policy because it will collapse and poison the policy ground”

Context of the Labor Government policy (2010-2012)

- Green party had the balance of power in the Senate and had rejected the emission trading system that caused the overthrow of Prime Minister Rudd
- New Prime Minister Gillard formed a coalition with the Green party who believe the only effect of a carbon price was to close industry down so it needed to be punitive.
- Designed by a committee of politicians and community advocates with insufficient input from “experts”

The failed Government policy

- Already Large subsidies to renewables directly and through a Mandatory Renewable Energy Target (MRET , 2001) on renewables share of electricity generation. 20% by 2020.
- A carbon tax at \$A23 per ton in July 2012 rising to \$A25.40 per ton in 2014-15
- Switch to a cap and trade carbon market in July 2015
 - Price ceiling \$20 per ton above international price (?)
 - Price floor (\$15) subsequently dropped and replaced by allowing permits to be imported from the European trading System
- Compensation to industry (permit allocation) and households (cash payments) based on forecast revenues not actual revenues

Assessing Ex-Ante

- How robust was the policy to possible economic futures?

What may go wrong?

- The world may not have an agreement so carbon credit that actually reduce emissions are not available
 - Carbon price would be very high in Australia given the target but global emissions would hardly change

What may go wrong?

- The world may have an agreement but the carbon price is less than \$15 per ton because of a global recession
 - Carbon price would drop from \$25.40 per ton to \$15 per ton in 2015 (if a floor) and many renewable investments would fail without access to the renewable energy fund
 - allowing European permits instead of the \$15 floor could be a serious problem if Europe price collapses

What may go wrong?

- The world has an agreement and there is a global carbon market.
 - Renewable targets drive energy prices up but Australia buys 50% of emissions from offshore and renewables don't penetrate the Australian market
 - Tens of billions of dollars of renewable funds have been wasted on infant industry arguments.

Other risks

- Compensation to households was promised in dollars not permits
- Risks to the fiscal position were increased
 - Revenue depend on the actual carbon price
 - Compensation depends on the forecast carbon price

Implications of Design

- Enormous uncertainty in the return to long term investments in abatement activities
- Better for companies to invest in lobbying for a policy change that to invest in reducing emissions

Problems with the Labor government policy

- No long term carbon price
- No long term carbon market
- Exclusions reduce the coverage so costs higher than needed
- Increased uncertainty that hurt investment
- Greater risk in the fiscal balance

What did go wrong?

- The policy kept changing
- Electricity Prices rose 110% from 2009-2014 (carbon tax 16% of bill in 12/13)
- The floor price was replaced by the link to the European ETS just as the European carbon price fell sharply

What did go wrong?

- The \$A rose sharply to \$US1.10 and \$US price of carbon rose
- Energy Intensive industry was closing
- Drop in nominal income growth damaged the long term budget outlook

New Coalition Government Policy “Direct Action”

- Reviewing subsidies to renewable energy
- Effectively the government pays for emissions reductions (almost baseline and credit) for anyone who volunteers a project
- Unlikely to reduce emissions at low cost because many low cost abatement activities not included.

Problems with the current Government policy

- No long term carbon price
- No long term carbon market
- Increased uncertainty damages investment incentives
- Greater risk in the fiscal balance
- Hard to scale up if more abatement is needed over time

Conclusion

- Climate policy debate in Australia is damaged because of bad policy design
- “Perfection has been the enemy of the good” is the claim by the advocates of the approach that failed.

Conclusion

- “bad policy design for a political purpose will eventually destroy any policy”

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