Australia’s rejection of carbon pricing would be a blow for EU efforts to link Europe’s emissions trading scheme with other parts of the world.

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The EU has attempted to tackle climate change through an emissions trading scheme, and has hoped for its scheme to become the core of an international system of linked-up carbon markets. **Frank Jotzo** *writes on developments in Australia following the country’s recent election. He notes that the new government, led by Tony Abbot, is committed to repealing Australia’s carbon pricing scheme. This has the potential to impact on the EU’s efforts to link up its emissions trading scheme with other systems, and could spillover into the approaches of other countries across the world.*

Australia’s newly elected conservative government under Prime Minister Tony Abbott campaigned hard against the “carbon tax” and has pledged to repeal the carbon pricing scheme. The move sends a negative signal to other countries considering price signals on emissions, and is a setback for the European Commission’s efforts to link up the EU emissions trading scheme (ETS) internationally.

Australia’s ‘carbon tax’

Australia’s carbon pricing scheme has been in operation since mid-2012. It works as a “fixed price” scheme for the first three years, with a price of A$24 (17 euros) per tonne of carbon dioxide, three times higher than the current EU emissions trading price. The fixed price phase acts rather like a carbon tax would: emitters buy permits directly from government at the pre-announced price, there is no international trading and no banking of permits.

Credit: David Joyce (CC-BY-SA-3.0)

The current legislation foresees a switch to a market-based emissions trading in mid-2015. The scheme would be linked with the EU ETS, and the price in the combined market would be close to the underlying EU price. Emitters would also be allowed to use a quota of cheap credits from the Clean Development Mechanism. Business compliance costs would be much lower, and overall economic costs of achieving Australia’s emissions target – currently set as a five per cent reduction at 2020 relative to 2000 – would be very low.

The new government however is politically locked into removing the carbon price altogether. The change is not guaranteed yet and it will take time because it will require negotiations in Australia’s Senate or a special election. The parliamentary situation, in a nutshell, is that the new government (the Coalition, comprising the Liberal and National party) does not have the numbers in the upper house. The Labor party, now in opposition, is unlikely to agree to the repeal of its climate policy legislation. The Senate changes composition in July 2014, and from then the government could achieve a majority for the changes if it can get the support of a number of cross-bench Senators.

The Coalition government has also pledged to get rid of a number of institutions that were created to help climate change policy analysis and implementation, in particular the Climate Change Authority (whose role is to advise government and Parliament on the national emissions target and policy instruments, akin to the UK Committee on Climate Change), the Clean Energy Finance Corporation (which has a $10 billion investment mandate to support renewable energy and energy efficiency projects) and the Climate Commission (which facilitates public information about climate change issues).

To replace the carbon pricing scheme, the new government plans to put in place an “emissions reduction fund”, a scheme where the government would pay companies to reduce emissions below a baseline. This approach shares some similarities with the UK “emissions trading scheme” that operated at a small scale from 2002 as a voluntary precursor of the EU ETS.

Economists are critical of this approach as this is seen as a less efficient way of cutting emissions. The reasons for this are that, first, its coverage will by design be more limited than that of the carbon pricing scheme which covers over sixty per cent of Australia’s emissions with a common price. Second, it will provide incentives only on the production side, not for end users because the cost of using fossil fuels would not rise. Last, it would create large transaction costs and a bureaucratic maelstrom potentially similar to that of the UN Clean Development Mechanism.

Environmentalists meanwhile are worried that the scheme will fall short of Australia’s emissions reductions target. Recent analysis suggests that much more money than budgeted would be needed to achieve a 5 per cent reduction in Australia’s emissions. But the budget is constrained, and Prime Minister Abbott made it clear that the government will not allocate additional money to the fund even if it falls short of its goals.

Implications for Europe

For policymakers in Europe, in particular Brussels and the member states supporting a stronger emissions trading scheme, this is bad news. Not so much because of the practical impacts on EU emissions trading markets – the expected demand from Australia was relatively small and would do very little to melt down the oversupply of EU permits. But there is a signalling effect in the EU-Australia emissions trading linkage being dumped, with the former suitor turning its back on carbon pricing altogether. It is a setback for the EU’s ambition to make the emissions trading scheme the core of a global system.

Perhaps the greatest adverse effect on cost-effective climate change policy is in other countries that are considering emissions trading or carbon taxes, in particular developing countries. Already the Australian development is being used as an argument by opponents of the carbon tax in South Africa . China, where a large effort is underway to test emissions trading regionally and possibly implement a national system, will probably be undeterred – but Chinese leaders will be bemused by the contradictory actions of an important trading partner.

Longer term, things could change again. Once the “carbon tax” issue loses its excessive political heat in Australia, mounting budgetary pressures will put the focus on carbon pricing as a source of government revenue as well as an efficient instrument for cutting emissions. If the emissions reduction fund has limited success and the government remains committed to achieving national emissions reductions without a price on carbon, then direct regulation is the answer. But command-and-control approaches tend to be more costly to the economy than action through price incentives, and it goes against the Abbott government’s deregulation drive and credo of business friendliness.

At the end of the day, emissions trading or a carbon tax is the obvious climate policy choice for a market economy.

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About the author

Frank Jotzo – *Australian National University*

Frank Jotzo is Associate Professor at the Crawford School of Public Policy at the Australian National University, and Director of the Centre for Climate Economics and Policy. He is currently a Dahrendorf visiting fellow at LSE, and a visiting researcher at the Centre for European Economic Research in Germany. He advised Australia's Garnaut Climate Change Review and is a lead author of the IPCC's 5th Assessment Report.

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