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The Emissions Reduction Fund: a critique

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Abstract

The Abbott Government's response to the problem of climate change is the 'direct action' proposal, a fig leaf to cover the gap left by their planned abolition of the carbon price. Its main component is an emissions reduction fund which will be used to pay firms tendering to reduce their CO₂ emissions below 'business as usual' levels. No credible experts believe the \$1.1 billion over four years allocated in the budget will suffice to reduce emissions to anywhere near the promised 5 per cent (from 2000 levels) by 2020, let alone the much larger reductions which would represent Australia's fair contribution to limiting global warming. Even were it better funded, the current sketchy version of the scheme, changed quite a deal from that taken to two elections, is still flawed in many ways. It fails to limit emissions. By only offering five-year contracts it will not affect long-term investment decisions. Taxes are higher so as to pay polluters. Past bad behaviour is rewarded and administrative expenses will be very high. Unsurprisingly, the overwhelming majority of economists oppose it.

Keywords

emissions reduction, direct action, climate change

Introduction

The emissions reduction fund (ERF) is the main element ¹ of the Abbott Government's so-called 'direct action' approach, which the Government (2014, p 1) claims will reduce Australia's greenhouse gas emissions "to meet its target of five per cent below 2000 levels by 2020".² The Government claims it can achieve this reduction without a carbon price through a 'competitive grant programme' whereby companies submit 'tenders' for actions that reduce greenhouse gas emissions and

¹ The 'million solar roofs' component of 'direct action' has been quietly abandoned. The remaining components are described in Coalition (2010, pp 23-30).

² The Department of the Environment's website (accessed 7 November 2013) says Australia will, under the Cancun agreements "unconditionally reduce its emissions by 5 per cent" and by up to 15 per cent if there is a global agreement involving "major developing countries commit to substantially restraining their emissions and advanced economies take on commitments comparable to Australia's". The Climate Change Authority (2014) says these conditions have been met but the Government never refers to this 15 per cent target.

the government pays those companies making the lowest bids (per tonne of abatement).³

This model of paying polluters is an unusual way of addressing a policy problem. It is akin to trying to reduce theft by paying burglars who promise to steal less, to prevent terrorism by paying extremists who promise to let off fewer bombs than they currently intend or to reduce lung cancer by paying heavy smokers who promise to smoke less.

Furthermore, there remains much scepticism about the sincerity of the Government's commitment to addressing climate change. Mr Abbott notoriously described the science of climate change as 'absolute crap' in 2009.⁴ More recently he said of coal mining that "I can think of few things more damaging to our future" than it being left in the ground⁵ when the scientific consensus is that to limit global warming to acceptable amounts, "most of the fossil fuel reserves must stay in the ground".⁶ Minister Hunt's Business Advisory Council⁷ includes climate change delusionists such as Dick Warburton⁸ and Hugh Morgan⁹ and others with little understanding of the economics of carbon pricing.¹⁰ Mr Abbott's own Business Advisory Council is headed by another climate change delusionist, Maurice Newman.¹¹

The Liberals did not promote 'direct action' with any enthusiasm at the 2013 election, not even bothering to update the written version from the 2010 election and dropping it off their website. In January 2013 the Coalition released a 50-page document

³ As Greg Hunt put it; "the [Coalition] government will simply buy back the lowest cost abatement"; opinion piece in *Australian Financial Review*, 24 October 2011, p 55. As Tony Abbott put it, "you go to the market and you say look, we are looking to buy cost effective emissions reductions"; interview with Ian Henscke, 7 March 2011, Tony Abbott's website.

⁴ At a public meeting in rural Victoria; Stuart Rintoul, *The Australian*, 12 December 2009. Interviewed on the ABC's *Four Corners*, Mr Abbott said "Um, I, I have pointed out in the past, ah that ah, there was that high year um, a few years ago, ah, and the warming ah, if you believe the various measuring ah, organisations, ah, hasn't increased". Asked about the IPCC report he said "I certainly think that there is a credible scientific counterpoint"; *Four Corners*, 16 August 2010. Addressing pensioners in 2011, Mr Abbott described the 5 per cent emissions reduction target in the direct action plan as 'crazy'; *Sydney Morning Herald*, 19 July 2011.

⁵ Tony Abbott, address to Annual Minerals Industry Parliamentary Dinner, 28 May 2014.

⁶ Steffen and Hughes (2013, p 4).

⁷ Greg Hunt, media release, 10 May 2011.

⁸ See, for example, his article in *Quadrant*, March 2011.

⁹ Hugh Morgan was president of the climate change denying Lavoisier Group; <http://www.lavoisier.com.au/lavoisier-about.php>.

¹⁰ Kate Carnell claimed that the impact of the carbon price on consumer prices would be 3 to 5 per cent; *Meet the Press*, 29 May 2011. The actual increase was 0.7 per cent or less.

¹¹ Mr Newman has described the science of climate change as "somewhat in tatters" and called subsidies for renewable energy "a crime against the people"; Lenore Taylor, *Guardian Australia*, 16 June 2013. He has described rising global temperatures as a "climate change myth"; *Australian Financial Review*, 17 September 2013.

called *Our Plan: Real Solutions for All Australians*, which allocated one paragraph to direct action.¹²

It is unsurprising that some Coalition ministers were not keen on promoting 'direct action' as they know it is an inferior approach to a carbon price. As Greg Hunt said in his thesis: "...the market system is a preferable regime, as it better ensures that the polluter bears full responsibility for the cost of his or her conduct".¹³ Mr Abbott and his mentor John Howard have both lauded emissions trading schemes as superior to alternative approaches in the past.¹⁴

As detailed below, the plan has changed a lot between the version presented at the 2010 and 2013 elections and that in the *White Paper*, notwithstanding the claims by Minister Hunt that "we haven't changed our system since day one. So, over three years we've been completely consistent".¹⁵ But it remains the case that few "Australians could explain it in detail, for the simple reason there is no detail".¹⁶

The Government hopes its tendering scheme could put a 'price' on carbon and lead to the least expensive abatement projects going ahead. There are however many implications of such a scheme that have not received much public discussion¹⁷, but which raise doubts about its effectiveness and fairness and may erode support for such a scheme;

- a company that has been operating inefficiently and polluting a lot has much more scope to put in a tender than a responsible firm that has already taken action to minimise its emissions. The scheme therefore penalises past good behaviour and rewards bad behaviour;
- the scheme requires the government to raise more tax revenue than it would otherwise need and then make payments to polluters. It therefore increases the 'churn' in the tax system. Those concerned with efficiency costs from taxation should prefer a scheme where a carbon price *replaces* some income tax

¹² There is scant reference to the ERF in Mr Abbott's recently released volume of speeches, *A Strong Australia*. According to one count, "carbon tax is mentioned over 106 times...Direct Action is mentioned just six times"; *Minister for Climate Change media release*, 28 November 2012. The Liberals' 'think tank' the Menzies Research Centre, recently released a book, *State of the Nation*, which did not regard climate change as meriting an entry among the 15 policy areas covered in essays, the only reference to reducing emissions being denouncing the carbon tax in the essay on resources policy, on the grounds it 'displeased' the coal industry; Markwell et al (2013, p 8). Similarly, a recent book of essays by Liberal 'intellectuals' called *Future-Proofing Australia* has an essay on protecting the mining industry, but not an essay on climate change, relegating it to a brief reference in an essay on water.

¹³ Greg Hunt and Rufus Black, 'A tax to make the polluter pay', <http://www.scribd.com/doc/50162694/A-Tax-to-Make-the-Polluter-Pay>.

¹⁴ See Hawkins (2014, pp 21-22).

¹⁵ *Lateline*, 18 April 2013. He made similar remarks in his speech to the Sydney Institute, 30 May 2013 and an interview with Latika Burke on *ABC 24* on 17 July 2013.

¹⁶ Former independent MP, Rob Oakeshott, (2014, p 343).

¹⁷ One exception is speeches by Greens leader Christine Milne, such as Milne (2013).

collections (as is the case with the Clean Energy Future package – the previous government’s carbon pricing mechanism);

- the cost of the scheme is borne by taxpayers and the benefits are received by the polluters;
- it gives no incentives for consumers, and firms not making successful tenders, to seek out ways of using energy more efficiently and provides little encouragement for the development of renewable energy; and
- as it only runs to 2020 it does not provide incentives for longer-term measures.

Following the September 2013 election, Mr Hunt set out a programme of the scheme starting on 1 July 2014 at the same time as the carbon price is removed.¹⁸ A supportive parliament might have allowed this timetable. But as of early June 2014 the current Senate has neither abolished the carbon price nor passed any supporting legislation to establish the ERF. A Senate committee recommended against the scheme.¹⁹ It remains to be seen what attitude the incoming Senate takes after July. Mr Abbott has said he would proceed to a double dissolution if he does not get his way, but this requires the Senate to reject the bills twice with at least three months in between, pushing the earliest date for a double dissolution out to late 2014 at the earliest.²⁰ Following a second election, it may then be necessary to hold a joint sitting for the legislation to be pushed through. All this would probably push the starting date into the second half of 2015. By this time the current scheme would be within months of transitioning into an emissions trading scheme with a (probably much lower) market-determined rather than fixed price (and so no longer be a so-called ‘carbon tax’).

The Government has marketed ‘direct action’ as an alternative to the current emissions trading scheme it has vilified. Ironically, in a speech to parliament in February 2009, Mr Hunt described ‘direct action’ as modelled on the NSW Government’s Greenhouse Gas Abatement Scheme, itself an emissions trading scheme.²¹

Practical details of the Government’s plan

The Coalition (2010, p 14) has described their plan as involving "businesses reducing their emissions below their individual baseline ('historical average')". In the *White Paper* it was revealed that baselines would be based on the highest annual emissions from the years 2009-10 to 2013-14, calculated from reports under the National Greenhouse and Energy Reporting Scheme (NGERS) and that baselines

¹⁸ Greg Hunt, media release, 16 October 2013.

¹⁹ The Senate Environment and Communications Committee (2014a, p 99) recommended “that the Emissions Reduction Fund not be substituted for the carbon pricing mechanism”.

²⁰ Greg Hunt’s claim that there would be an “immediate double dissolution” if the repeal of the carbon price is rejected was clearly impossible. His claim was in Hunt (2012b); interview on *Sky Agenda*, 1 July 2012 and *The Drum*, 11 January 2013.

²¹ An irony noted in Rob Oakeshott (2014, pp 158-9).

would be based on emissions intensity (emissions per unit of production), implying a firm could receive funding while actually *increasing* their absolute emissions.²²

Businesses not currently reporting under NGERs will also be able to bid, but it is not clear how their baselines will be assessed. Nor is it clear how a new firm would be treated as they do not have a baseline to go below. Some companies may have substantially changed the nature of their operations, selling or buying individual plants or changing what they produce, which would make their baselines misleading.

The bids have to be for projects that would not otherwise proceed. This creates a serious problem for a firm that submits an unsuccessful bid to reduce emissions. It then cannot later undertake that action that would reduce emissions because that could be seen as indicating it had made a false claim in its bid. So the scheme will actually *prevent* many firms from reducing emissions.

The auctions will be held quarterly, so long as the number of registered bidders exceeds an unspecified minimum, with a minimum bid size of 2,000 tonnes per year.²³ The *White Paper* refers to “a benchmark price for each auction, above which bids will not be considered” which will generally be unpublished and calculated in a non-transparent manner,²⁴ thereby adding another complication and uncertainty to the bidding process.

Even after the release of the *White Paper*, there are many aspects remaining unclear. The *White Paper* refers to “project risk and commercial readiness being assessed in the pre-qualification phase”²⁵ – but what does this actually mean? Is there some threshold of riskiness beyond which projects will not be considered? Will there be any time period within which successful projects must commence?²⁶ Will unsuccessful tenderers have any avenue for appeal? There are also vague provisions for large projects to be awarded contracts on an ‘out-of-auction’ basis.²⁷

The scheme does not provide the certainty that business claims they need to make their investment plans. Most obviously, firms will not know whether their bid will be successful. But also the scheme will be reviewed and possibly revised in 2015.²⁸ As Malcolm Turnbull put it, “it can be easily terminated...If you believe climate change is going to be proved to be unreal, then a scheme like that can be brought to an end”.²⁹

²² Australian Government (2014, p 31).

²³ Australian Government (2014, p 45).

²⁴ Australian Government (2014, pp 11, 44).

²⁵ Australian Government (2014, p 42).

²⁶ This is particularly an issue as an ANAO study found that previous competitive grant schemes took significantly longer to achieve any abatement than originally planned; Denniss and Grudnoff, (2011, p 3).

²⁷ Australian Government (2014, p 48).

²⁸ Australian Government (2014, p 15).

²⁹ Malcolm Turnbull, *Lateline*, 18 May 2011.

Another source of uncertainty for business is that the Government's plan only runs to 2020, and only offers contracts running for five years, notwithstanding Mr Hunt's claim that it is a "20 year system".³⁰ As Malcolm Turnbull has commented; "because most capital equipment, especially in the energy sector, has a life running into many decades, as long as 50 years in some cases, the business sector is going to require assurance that any government subsidy will match the life of the asset— so running well beyond 2020...If government wants business to make long-term investments to lower emissions, its commitment must be long term as well, which is why a subsidy scheme which terminates in 2020 will achieve very little." ³¹

Is the ERF adequately funded to achieve claimed emissions reductions?

The Coalition (2010, p 13) initially said the ERF would cost \$2.6 billion over 4 years, and an average of \$1.2 billion per year through to 2020 (Table 1).³² If the cost increased roughly linearly over time, this would imply a cost of around \$2 billion a year by 2020.³³ The estimated cost over the first three years was remarkably constant from 2010 to 2013 despite variations in actual emissions and the carbon price in overseas schemes. Suddenly in the 2014 budget, the cost has dropped markedly. The explanation given was that, as the scheme was 'payment on delivery', the payments would not occur until well after the tenders were awarded. It is not clear why this was only suddenly realised at the time of the budget.³⁴ No explanation was given as to why the medium-term cost of the scheme has dropped from almost \$11 billion to under \$3 billion.

No explanation has been given of who prepared the initial costing or the basis of the calculation. It implied a cost in 2020 of at most \$14 per tonne (\$2 billion/140 million tonnes) to cut emissions (assuming all the cost goes to payments, although as noted below the administrative costs will be large).³⁵ This has always seemed optimistic; the Labor Government's scheme started with a carbon price of \$23 a tonne and Mr Hunt is not claiming that it is massively overachieving on emissions reduction. The

³⁰ 7.30, ABC TV, 15 July 2013.

³¹ Malcolm Turnbull MHR, *House of Representatives Hansard*, 8 February 2010, p 581. The five year limit has been widely criticised; see Senate Economics and Communications References Committee (2010a, pp 112-114).

³² Mr Abbott agreed the cumulative cost would be around \$10.5 billion by 2020; interview with Chris Ullmann, 7.30, 4 July 2011, ABC website.

³³ \$2 billion was also Malcolm Turnbull's estimate of the cost in 2020; <http://www.malcolmtturnbull.com.au/blogs/malcolms-blog/the-lateline-interview-response-to-critics/>

³⁴ The 'payment on delivery' approach also means that the scheme no longer helps firms meet the cash flow requirements of taking action to reduce emissions, notwithstanding Mr Hunt's (2012a) earlier claims that "many industries face substantial capital expenditure costs in reducing their CO₂ emissions" and that under his scheme "the capital will be available for business to conduct emission reduction activities".

³⁵ Minister Hunt has publicly referred to a cost of \$15 per tonne; ABC 24, 18 May 2011, cited in <http://www.climatechange.gov.au/minister/greg-combet/2011/media-releases/May/mr20110518.aspx>.

Government is relying on soil carbon to achieve a large proportion of the reduction in emissions at a very low cost but this is very doubtful.³⁶

Table 1. Comparison of the reported cost of the Emissions Reduction Fund (\$ million) from 2010 to 2014

	1 st year	2 nd year	3 rd year	4 th year	sum	Up to 2020
Original proposal (2010)	300	500	750	1000	2550	10800
	2014-15	2015-16	2016-17	2017-18		Over 10 years
Green paper (2013)	300	500	750			
MYEFO (December 2013)	Included	in	contingency	reserve		
White paper (April 2014)	300	500	750	1000	2550	
Budget (May 2014)	76	300	355	417	1148	2550

Sources: Coalition (2010, pp 13, 30); Australian Government (2013, p); *Mid-Year Economic and Fiscal Outlook 2013-14*, p 64; Australian Government (2014, p); *2014-15 Budget Paper No 2*, p 102; *2014-15 Budget Overview*, p 27.

Nor has any modelling underpinning the cost estimates in the budget, or the estimated amount of emissions reduction they would achieve, been released. Senator Birmingham, the parliamentary secretary, was asked at the recent Budget Estimates eight times to release any modelling and replied seven times that he was 'confident' that the targets would be met but he would not say whether there had been any modelling done.³⁷

Minister Hunt has been emphatic about the costings, referring to them as "fixed, capped costs...we will not spend a dollar more".³⁸ This seemed an extraordinary degree of confidence about the outcome of an auction to be held months or years away. During the latter stages of the 2013 election campaign Mr Abbott was clearer, saying that if the available funds proved insufficient to buy emissions reductions of 5 per cent, then the promise on emissions would just be abandoned rather than additional funding being provided.

If, as Mr Hunt used to imply, the estimated cost is a fair estimate of the likely cost of the successful bids, this means there is a 50 per cent chance that the cost of achieving the emissions goal would exceed this, and therefore Mr Abbott and Mr Hunt are effectively saying there is at least a 50 per cent chance that the Coalition will break their promise on emissions reduction.

³⁶ See Hawkins (2014, pp 14-16) and the references cited therein.

³⁷ Senate Environment and Communications Legislation Committee (2014b, pp 74-75).

³⁸ Minister Hunt, interview with Kieren Gilbert, *Sky News*, 12 February 2013.

There are a large number of studies which find that the funds allocated to the ERF will not be sufficient to achieve the 5 per cent emissions reduction aspiration once the carbon price is abolished. The Climate Change Authority (2014, p 8) has predicted that ‘in the absence of a carbon price or other effective policies, emissions are expected to grow to 685 Mt CO₂e in 2020, 17 per cent above 2000 levels”.

When the Department of Climate Change (2010a, b) assessed the ‘direct action’ scheme, it found "the costs claimed...very difficult to support on the basis of relevant experience". If expenditure on the scheme were capped at the \$1.2 billion a year average up to 2020, as set out in Coalition (2010, p 13), the Department of Climate Change (2010, p 3) estimated, based on 'multiple estimation methodologies' that emissions in 2020 would be 13 per cent above 2000 levels rather than 5 per cent below. The amount now proposed to be allocated is much less than the \$1.2 billion a year average used in this calculation.³⁹

Treasury commented in its 2010 incoming government brief that "the mitigation task to achieve your commitment to reduce national emissions to 5 per cent below 2000 levels by 2020 is significant. It cannot be achieved without a carbon price if damaging economic and budget impacts are to be avoided. Direct action initiatives alone will not do the job."⁴⁰ Treasury has refused to release its 2013 incoming government brief.

The Senate committee reported that “an overwhelming number of submissions and witnesses expressed doubt about whether the Direct Action Plan and the ERF could achieve Australia’s existing emissions reduction targets”.⁴¹ Reputex Carbon (2013, p 5) estimate that under the ERF emissions would increase by around 16 per cent by 2020.⁴² The head of the Australian Renewable Energy Agency said “the amount of abatement that could be directly purchased is going to be, in my own view, way, way less than Greg Hunt would like...I think direct action will fall at the first hurdle and be seen enormously wanting”.⁴³ Experience with similar schemes also suggests that the Coalition plan is under-funded.⁴⁴ Even the Institute of Public Affairs, normally strong

³⁹ Similarly, a costing of direct action by government departments in 2013 suggests that its costs over the forward estimates period would be around \$13 billion more than the Coalition asserts. Even that costing is regarded as “a lower bound, as it is extremely unlikely that a grant tendering scheme would yield lowest cost abatement; Minster Wong, ‘Opposition budget 2013’, 3 August 2013.

⁴⁰ Department of the Treasury, http://pandora.nla.gov.au/pan/123021/20101029-1442/www.treasury.gov.au/documents/1875/PDF/Red_Book_Part_1_Redacted.pdf p 10.

⁴¹ Senate Environment and Communications References Committee (2014a, p 77).

⁴² An analysis by the Climate Institute (2013) and Sinclair Knight Merritz (2013) suggested that ‘direct action’ would fail to achieve emissions reductions if the cost is limited to the caps set by the Coalition; and an additional \$4 billion would be needed to achieve the 5 per cent emissions reduction. The analysis, however, is based on unreasonably favourable assumptions. In particular it assumes that the companies submit bids reflecting their costs of abatement rather than a market clearing price.

⁴³ Mr Greg Bourne, quoted in *Australian Financial Review*, 28 May 2014, p 5.

⁴⁴ A Grattan Institute study examined 300 policies and programmes within Australia since 1997 aimed at reducing emissions and concluded "analysis of a range of grant-tendering programs...shows that they cannot reduce emissions at the necessary scale or speed...Based on experience, government would need to announce an abatement purchasing fund of \$100 billion to meet the 2020 emissions

supporters of the Government, are sceptical, saying "it would be very difficult for it to achieve its goals".⁴⁵

Some optimists about the cost of reducing emissions point to research by McKinsey consultants on the 'cost curve'. It shows that some reductions in emissions, especially through energy-efficiency measures in buildings, are costless and others are low cost.⁴⁶ But it is surprising that firms are not already planning to undertake the costless emissions reductions programmes and the ERF is not meant to pay firms for activities they would undertake anyway.

A big problem for such a tender system is that even if some firms could afford to tender at very low prices, they will not do so when they expect that higher prices will still be winning bids. The Department of Climate Change (2010a, p 21) observed that "in practice in multi-round environmental tenders in Australia and internationally, quickly bids converge to close to the highest bid from previous rounds".⁴⁷ As one commentator put it "It's like when you offer your house for sale. You don't price it based on what you paid for it" but what people are currently paying for similar houses in the surrounding area.⁴⁸

Furthermore, as the Department of Climate Change (2010a, p 11) have pointed out, "community perceptions of fairness may make it difficult to maintain large differences in the price paid for abatement projects (for example by paying farmers a different price for land management activities than provided to power generators for a change in the fuel mix)".

The cost of achieving reducing emissions equivalent to cutting Australia's domestic emissions to 5 per cent below 1990 levels could be lowered substantially if some of the abatement was purchased abroad.⁴⁹ But the Coalition opposes any purchase of emissions reductions from other countries.⁵⁰ This does not appear to be based on a legitimate concern to ensure that any purchases overseas are from sound schemes that deliver genuine emissions reductions or a desire to demonstrate that Australia

reduction target; Daley and Edis (2011, p 3). A similar estimate is reached by Denniss and Grudnoff (2011, p 4).

⁴⁵ Dr Alan Moran, Institute of Public Affairs, *Joint Select Committee on Clean Energy Future Hansard*, 27 September 2011, p 62.

⁴⁶ See for example McKinsey & Co, (2008, p 6). The 'cost curve' is shown on p 14.

⁴⁷ Similarly, Treasury (2011) has said "there are a number of reasons why sustained price discrimination is unlikely to be practical: the government is often at a substantial information disadvantage compared to the firm bidding for the abatement activity and firms also tend to act strategically which leads to convergence of bids at a higher final price".

⁴⁸ "Irrespective of whether you paid \$50,000 or \$500,000 for your house, if other people are selling similar homes for \$700,000, that's what you'll ask for"; Edis (2013a).

⁴⁹ McKinsey (2008, p 18) point this out. The Business Council called for "no restriction on the number and type of international permits that can be used to meet Australia's obligations"; Lenore Taylor, 'Abbott plan would double carbon cost', *Sydney Morning Herald*, 15 September 2011.

⁵⁰ As Coalition (2010, pp 2 and 14) puts it, "we don't believe Australians should have to pay a great big new tax to fund outcomes in other countries". Tony Abbott said at a press conference on 15 August 2013 that "if you simply buy international offsets, there is a sense in which you are shirking your environmental duty".

can achieve significant emissions reductions. It appears to be an odd view that only emissions reductions in Australia will reduce the impact of climate change in Australia. Ruling out any contribution from international action means that the reductions in the prices of permits in the EU scheme do not cut the cost of the Coalition's approach.

Assessing the bids

In the Coalition's original version, the bidding process would have been extremely complex as the bids were not just to have been assessed on the claimed emissions reductions relative to a baseline, but have to take into account a variety of other, including qualitative, aspects. Under the version of the scheme taken to the 2010 and 2013 elections, Coalition (2010, pp 13-15), "to ensure the Fund supports a broad range of direct action initiatives, measures considered by the Fund will be assessed against similar proposals from similar sectors. Assessment of projects will also take into account any additional significant public policy benefits" and a tender would only be accepted if the tenderer could prove that the project would deliver additional practical environmental benefits, not result in price increases to consumers and protect Australian jobs. This massive bureaucratic undertaking has been quietly abandoned.

This would seem to mean that earlier assurances that the scheme would not lead to higher prices for consumers no longer hold. For example, Mr Hunt had said of power stations that "our approach would be - potentially - to provide them with incentives... [but] unless costs [to consumers] remain the same, we would find other means of reducing emissions".⁵¹ Mr Abbott had said "we won't be purchasing outcomes that do increase the price to consumers".⁵²

While successful bidders who do not meet their promised emissions reductions will not receive their payments, the Coalition has said little about the extent of any fines for non-performance. The *White Paper* says "contracts will include provisions to 'make-good', unless under-delivery is not reasonably within the control of the proponent".⁵³ If these provisions are to be stringent, they will discourage firms with any doubts about their projects from tendering and so raise the cost of the scheme. If they are weak, many – perhaps most – of the successful tenders will be from firms with speculative bids based on wishful thinking about the subsequent emissions reductions, and so the emissions reductions achieved will be even smaller. By the time it is realised that emissions reductions are not occurring, it will be too late to accept other bids.

Assessing the tenders to ensure that they do involve genuine reductions in emissions will not be an easy task. As Malcolm Turnbull has said, "if a scheme

⁵¹ Greg Hunt MP, interview with Chris Uhlmann, 7.30, 24 May 2011, ABC website.

⁵² Tony Abbott MP, interview with Chris Uhlmann, 7.30, 4 July 2011, ABC website.

⁵³ Australian Government (2014, p 9).

operates whereby the government pays the firm to reduce its emissions intensity...there is firstly going to be a substantial and contentious debate about what the correct baseline is, and then whether it will actually be reduced...Arguments of considerable ferocity will arise as to whether a new piece of equipment would have been bought anyway, with the risk that the government ends up funnelling billions of dollars to companies to subsidise their profit without achieving any real additional cuts in emissions."⁵⁴ The more firms are paid for emissions reductions they are currently undertaking anyway, the less likely is the 5 per cent reduction target to be met.

A study by Daley and Edis (2011, p 21) of the experience of governments in assessing tenders for emissions reductions is instructive: "the tender process itself usually takes several years to select the projects and finalise funding agreements. Government tends to struggle to identify the best projects. The assessments required are inherently difficult because the projects often involve cutting edge technology or are highly complex. The process favours overoptimistic bids, which then makes completion unlikely. Furthermore over the long periods involved in rolling out grant tendering programs, unforeseen changes unfold that result in winning bidders' projects becoming uncommercial. At best these programs are a wasteful distraction, since most of the money is never spent".⁵⁵

Other apparently abandoned aspects of the scheme

Another aspect of the scheme presented to the electorate that has apparently been abandoned is the vague and uncosted reference in Coalition (2010, p 17) to "work with the electricity sector on the design of potential assistance that could be provided through the Fund to ensure both fairness and cost parity for consumers".

Similarly, there is no reference in the *White Paper* to any compensation for companies such as Hydro Tasmania that would lose from abolition of the carbon price. Treasurer Hockey had said that compensation would be considered "on a case

⁵⁴ Malcolm Turnbull MHR, *House of Representatives Hansard*, 8 February 2010, p 581.

⁵⁵ A similar conclusion was reached by the Australian National Audit Office (2010, p 21). Its evaluation of GGAP, a competitive grants programme similar to the direct action programme, "noted shortcomings in the assessment of projects for the first two rounds of the GGAP. The third round also had significant shortcomings in the assessment process...None of the shortlisted project proposals recommended by the department could provide the large scale abatement at low cost, and with a high degree of certainty required by the program's guidelines. The three highest ranked (and recommended) projects were technically ineligible as they did not meet the Australian Government's primary criteria for the program. For these three projects, which were subsequently approved by the then Minister, only one project has produced any abatement to date. However, this was less than one third of the threshold specified for the program." The Howard Government's Green Gas Abatement Program, also similar to the 'direct action' scheme, achieved less than half of the abatement planned due to low take-up by business, according to the Department of Climate Change (2010a, pp 7-8). The experience of firms tendering is also informative: "Many bidders interviewed by the Grattan Institute indicated that the lack of clarity around how criteria might be interpreted made it very difficult to develop bids and make informed judgements about future investment decisions"; Daley and Edis (2011, p 26).

by case basis” and claimed “we have allocated funds under our Direct Action plan to deal with initiatives that are underway”.⁵⁶

Administrative costs

Professor Ross Garnaut (2014) has criticised the “huge and intrusive bureaucratic exercise” that direct action involves.⁵⁷ The head of the Department of Climate Change said the Coalition's approach would “clearly be more resources intensive” to operate.⁵⁸ His department (2010a) described it as having “high administrative overheads for government and business” and commented specifically that “soil carbon purchasing would inherently involve higher administrative overheads than other abatement due to the multiplicity of small scale grants”. And because it is an auction, nothing can happen until every tender has been assessed.

Once the successful tenders are selected, for the expenditure to be effective it will be necessary to check that the promised emissions reductions are actually being implemented by the successful bidders, and verify that they would not have occurred without the support. This will require a lot of inspectors empowered to investigate companies' operations in a quite intrusive way.

Penalties

The *White Paper* has not done a lot to clarify the brief confusing references in the original paper to a penalty system for firms which increase emissions. The *White Paper* states that “no revenue from firms is sought”⁵⁹ from penalties, an interesting comment given the criticism the Opposition has made of ‘taxes that raise no revenue’ in the context of the mining tax debate.

The penalties, which are now referred to as a ‘safeguard mechanism’, will operate from July 2015. They will only apply to facilities emitting over 100,000 tonnes a year, thereby exempting firms that account for around half Australia’s emissions.⁶⁰ The methodology for calculating ‘baselines’ for the safeguard mechanism is still being developed and may well differ from the approach to calculating benchmarks for assessing tenders.⁶¹ The “baselines will be set using the highest level of reported

⁵⁶ *Sydney Morning Herald*, 25 February 2013.

⁵⁷ The Australia Institute calculates that “If we make the generous assumption that the average abatement per project under the Coalition’s scheme is 25,000 tonnes of emissions then there would need to be about 28,500 successful projects. If we assume four unsuccessful projects for every successful one then the number of projects assessed would be close to 150,000”; Denniss and Grudnoff, (2011, p 5). This may be conservative as the NSW Government’s Greenhouse Gas Abatement Programme had about nine unsuccessful applications for every successful one.

⁵⁸ Mr Blair Comley, Secretary, Department of Climate Change and Energy Efficiency, Senate Environment and Communications Legislation Committee, *Supplementary Estimates Hansard*, 17 October 2011, p 12.

⁵⁹ Australian Government (2014, p 12).

⁶⁰ Australian Government (2014, p 52).

⁶¹ Dr Steven Kennedy, Deputy Secretary, Department of the Environment, in Senate Environment and Communications Legislation Committee (2014b, pp 79-80).

emissions for a facility over the historical period 2009–10 to 2013–14” but there is a vague reference to “flexibility could be provided where a business’ emissions rise above absolute baselines, but that business can demonstrate that its emissions-intensity of production is not rising”.⁶²

More ambitious targets

Another criticism of the direct action scheme is that "many of the direct action measures cannot be scaled up to achieve significant levels of abatement. For those that can be scaled up, the cost per tonne of abatement would rise rapidly, imposing further costs on taxpayers and consumers."⁶³

This is important as the 5 per cent target is manifestly inadequate. Especially as Australia is one of the world’s highest per capita emitters, one of the world’s wealthiest economies and one of the countries likely to be most adversely affected by global warming, a 5 per cent reduction does not represent a fair share of the global effort required to restrain global warming to less than 2 degrees.⁶⁴

The Climate Change Authority (2014, pp 9-10) has recommended “a minimum 2020 target of 15 per cent below 2000 levels” as “a 5 per cent target for 2020 would not be a credible start by Australia towards achieving the below 2 degree goal. It would leave an improbably large task for future Australians to make a fair contribution to global efforts”.

Views on the direct action plan

Around 25 Nobel prize winners in economics have expressed support for a carbon tax or emissions trading scheme but none have come out in favour of a tender system such as ‘direct action’.⁶⁵ Fairfax Media surveyed 35 Australian academic and business economists; 30 replied that a carbon price was superior to ‘direct action’, three rejected both, one favoured ‘direct action’ because it was really ‘no action’ and the other was a climate sceptic.⁶⁶

⁶² Australian Government (2014, pp 53-55).

⁶³ Department of the Treasury, incoming government brief, http://pandora.nla.gov.au/pan/123021/20101029-1442/www.treasury.gov.au/documents/1875/PDF/Red_Book_Part_1_Redacted.pdf, pp 10 and 11. Treasury secretary Dr Martin Parkinson commented "we did not believe the direct action programme could be scaled", *Senate Select Committee on Scrutiny of New Taxes Hansard*, 24 March 2011, p 26.

⁶⁴ For a summary of arguments by the organisations that support this view, see Senate Environment and Communications References Committee (2014a, pp 14-22).

⁶⁵ Hawkins (2014, pp 23-24). Mr Hunt (2013) misleadingly suggested that three Nobel Prize winners (Thomas Schelling, Vernon Smith and Finn Kydland) prefer direct action to a carbon price. They actually preferred research into geo-engineering and other technology as a means of addressing climate change to policies that reduce emissions. They were rejecting ‘direct action’ as much as a carbon price. Indeed they were not asked to look at a ‘direct action’ model as “it is well known that a uniform carbon tax is the cheapest way to abate emissions”; Tol (2010, p 74).

⁶⁶ ‘Tony Abbott’s new direct action sceptics’, *Sydney Morning Herald*, 28 October 2013. Dr Chris Caton from BT Financial said that any economist who preferred direct action ‘should hand his degree

A wide range of corporate representatives have indicated that the direct action scheme is inferior to pricing carbon or have criticised the lack of information about the proposal.⁶⁷ Even groups usually close to the Coalition are unsupportive. The Business Council “believe the most effective system to reduce emissions is one primarily based on a market solution, such as an emissions trading system”.⁶⁸ The Institute of Public Affairs has called direct action “undesirable” and conceded that “emissions trading schemes are arguably more efficient”.⁶⁹

Concluding remarks – global implications

Especially at a time when the science of climate change is becoming firmer, and Australian meteorologists are adding new colours to temperature maps to reflect unprecedented warming⁷⁰, for Australia to replace a credible emissions trading scheme with a sketchy so-called ‘direct action’ plan will have adverse impacts beyond our shores. It will be misrepresented as indicating that carbon pricing had a serious adverse impact on the Australian economy and so set back the cause of climate action in other countries. Among better informed international audiences it will be seen as an act of selfishness by a rich country unwilling to contribute its share to international action.⁷¹

Biography

John Hawkins is a PhD student at the Australian National University. He has a Masters degree from the London School of Economics and has worked in senior positions at the Reserve Bank, Bank for International Settlements and the Australian Treasury. He served as secretary to the Senate Economics Committee and the Senate Select Committee on Climate Policy.

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back’. This accords with a poll conducted at the Australian Conference of Economists which asked whether “the Coalition’s Direct Action approach to greenhouse gas emissions is good economic policy”. Of the 145 respondents, only 11 per cent agreed and 62 per cent disagreed (of which 43 per cent disagreed strongly).

⁶⁷ For examples, see Hawkins (2014, pp 18-19).

⁶⁸ <http://www.bca.com.au/Content/101469.aspx>. (accessed 6 March 2013).

⁶⁹ Tim Wilson, Director of Climate Change Policy, Institute of Public Affairs, (2013).

⁷⁰ *The Economist*, 12 January 2013, pp 24-26. 2013 was Australia’s hottest year on record.

⁷¹ In Europe it may be seen as Australia reneging on the agreement to link the EU and Australian schemes.

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