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Don't repeat Rudd's compensation mistakes

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Free permits to high emitters would mean business as usual, write ***John Daley and Tristan Edis.***

Is it groundhog day in climate change policy? Prime Minister Julia Gillard suggested last week that when her government sets a carbon price, big carbon emitters are likely to receive the same level of compensation payouts they were promised under the Rudd government's failed emissions trading scheme.

The Prime Minister should think again.

Such payments would not only be a massive handout to high-emitting industries, they would undermine the purpose of setting a carbon price, which is to change the behaviour of industry and individuals so that, as a nation, we emit less carbon.

Last April, the Grattan Institute published the most detailed study to date of how much the Rudd government's planned (and later abandoned) Carbon Pollution Reduction Scheme would cost companies and industries. For most, the answer was not a great deal. Taxpayers though would have footed a bill of at least $20 billion for an excessively generous and unnecessary scheme of free permits to high carbon emitters.

Rudd's caution as prime minister can be partly explained by the threat of the global financial crisis and the need to provide concessions to the Liberal opposition to get his bill through the Senate.

Gillard faces neither of these obstacles. Instead, she is under pressure to make cuts to get the federal budget into surplus. Why, then, would she make the same mistake as her predecessor?

She has shown courage in recent weeks in axing poorly conceived climate programs such as the Cash for Clunkers scheme – a lot of bucks to achieve a tiny bang in emission reductions – and the Green Car Innovation Fund, which was merely a car industry subsidy dressed up as a green initiative. Neither would have changed behaviour. Nor would a huge and unnecessary industry compensation scheme.

In last year's report, the Grattan Institute used industry data to examine the effect of the carbon price of $35 per tonne of CO_2, expected under the Rudd government's scheme, on seven major industries – steel, cement, coal, liquefied natural gas (LNG), aluminium smelting, alumina refining, and oil refining.

These industries, which produce about one-fifth of all of Australia's greenhouse emissions, are both high emitters and exposed to international competition. The Rudd government decided to "compensate" them in the form of free permits to emit carbon.

But our study found ample evidence that a carbon price would not force most of these industries overseas or have a substantial impact on job levels.

Of the industries we studied, alumina refining, LNG production and coalmining are low-cost producers compared with the rest of the world. These companies will continue to be profitable after paying a carbon price, and will not be relocating production overseas.

What free permits will do, however, is weaken the incentive to move to more efficient processes or low-emission mines and prepare these industries for a carbon-constrained global economy. Compensation means it will be business as usual.

By contrast, most aluminium and oil refining is likely to move offshore under a carbon price. But we should not resist this. For one, these industries are high emitters compared with their overseas counterparts, so their relocation is likely to reduce global emissions. Secondly, both industries are likely to relocate in the long run anyway, as they are also high-cost compared with overseas competitors. Providing them with free permits simply shifts the burden to taxpayers.

Under the Carbon Pollution Reduction Scheme, the aluminium industry would have received permits worth $811 million a year. That represented an annual subsidy of $161,000 per person employed in the aluminium industry – a very expensive job-support scheme. It would have been far better to spend some of that money helping workers and communities affected to transition to a low-carbon future.

The two high-emitting industries that deserve government consideration are cement and steel. Both could become marginal under a carbon price, leading to production moving offshore.

But far more effective than providing free permits – which will slow the move to less emission-intensive processes and substitutes – would be to provide a carbon rebate to exporters and impose a carbon charge on imports.

Such a change, which we believe can be made consistent with international rules on free trade, would keep the playing field level while still encouraging Australian producers to improve their carbon efficiency.

The Prime Minister has said that a carbon price is about changing the way our economy works. She has compared it to the big decisions of the Hawke and Keating government to restructure the economy. But that government knew its decisions would produce losers and therefore required courage. Its tariff cuts reduced employment in the car industry by 55,000 and in textiles by 64,000.

By contrast, less than 10,000 people work in the high-emitting aluminium and oil-refining facilities at genuine risk of closure.

With limited incentives to reduce emissions, these industries will not change. The burden of cutting emissions will fall on the electricity and transport sectors, and therefore onto consumers.

If Australia is serious about fighting global warming, all industries must play their part.

Ross Garnaut, climate change adviser to the Rudd government and a strong critic of excessive compensation to high emitters, described the policymaking process that produced the Carbon Pollution Reduction Scheme as one of the worst on record on a major issue in Australian history.

It is not too late for Julia Gillard to choose a different path.

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