

www.grattan.edu.au

Markets still the best option to reduce greenhouse gas emissions

Published in The Australian, page 12, Thursday 7 April 2011

*A well-designed carbon market will let business get on with fixing the problem, write **John Daley and Tristan Edis.***

Australian politics is locked in a fierce debate about how to tackle climate change. To many, arguments about whether a carbon tax or trading scheme is better than other approaches must seem confusing.

Australian governments have introduced more than 300 programs, worth more than \$12 billion, to reduce carbon emissions since Australia signed the Kyoto Protocol in 1997. And the jury is in: the market works best to reduce emissions at the necessary scale and speed.

A new Grattan Institute report, *Learning the hard way: Australian policies to reduce carbon emissions*, analyses these 300 programs and finds that three market-based schemes have produced 40 per cent of Australia's emissions reductions since 1997 (excluding one-off bans on land clearing). Energy efficiency regulations account for much of the remainder.

The schemes - the commonwealth's Renewable Energy Target, the NSW and ACT Greenhouse Gas Abatement Scheme and Queensland's Gas Electricity Target - are not perfect, but they have reduced emissions quickly and relatively cheaply.

By contrast, in the past 14 years federal and state governments have announced \$7bn worth of grant-tendering schemes - up-front grants to companies for proposals to reduce their emissions - that have done very little to reduce greenhouse gas pollution. Most of the money is never spent as the inevitably drawn-out process leads to lists of failed projects.

Governments have also spent \$5bn on rebate programs to encourage companies and individuals to purchase low-emission products, without any discernible impact on material growth.

Even before the introduction of a carbon tax and trading scheme, Australia's existing market-based schemes are forecast to reduce emissions by 40 million tonnes by 2020 (equivalent to removing eight million cars from the nation's roads). Grant-tendering schemes and rebate programs are forecast to reduce annual emissions by a fraction of this amount, by 7.2 million tonnes and up to 1.9 million tonnes respectively by 2020.

So ineffectual have grant-tendering schemes been that if governments tried to use them to meet Australia's target of a 5 per cent reduction in emissions over 2000 levels by 2020, they would need to spend another \$100bn.

The cost of meeting the target through rebate programs would be even more prohibitive, requiring \$300bn, nearly a quarter of Australia's current annual GDP.

The Grattan report found that a fourth kind of program, energy efficiency standards for products and buildings, can also reduce emissions cheaply and effectively. But because they are limited in scope and slow to take effect, they cannot do more than support a carbon trading scheme.

Reducing emissions by 5 per cent by 2020 is equivalent to not only eliminating emissions from all of Australia's planes, trains and automobiles but also replacing the use of gas for heating and industrial production with a zero emission energy source.

It is no small task, and based on Australia's experience to date, only a market-based model can accomplish it. A well-designed carbon market with a transparent price and clear rules provides certainty, enabling business to invest with confidence and for the long term in low-emissions plant and

technology. It also provides for flexibility and human ingenuity. It devolves decision-making to businesses and individuals, allowing them to decide how best to reduce their emissions.

Finally, markets reduce the need for governments to predict the future, something that, like the rest of us, they are not always good at doing.

The trouble with grant-tendering schemes is that they require governments to make decisions about technologies and business plans that are not only beyond government expertise but in many cases will not be realised until years into the future. The evidence is that very few successful grant tenders ever come to fruition as operating projects.

Rebates also fail because governments fail to predict the future. When demand is higher than expected, governments facing unexpected budget blowouts adjust the conditions of rebate programs, on average every 12 months with the rebates we studied. Or they suddenly shut them down, as they did for insulation and solar photovoltaic systems. This can create a boom-bust cycle in the product and damage the industry and the confidence of its investors.

All the evidence from Australia and overseas shows that when companies are given the flexibility to reduce emissions through a market mechanism, they do so far more inventively and cheaply than experts predicted.

That does not mean markets are perfect or that government has no role. Far from it. Good market design is vital. The scope of the market should be as broad as possible, to include the widest variety of emission-reducing activities.

Government should also set a floor to prevent the carbon price falling too low, potentially destroying the value of the market, if emissions reduction turns out to be easier than anticipated.

The beauty of a market-based scheme is that it establishes the worth of any emissions-reduction activity.

Lately there has been much debate about the potential of storing carbon in soil. So-called green carbon is promising but highly uncertain. Rather than committing to it under a risky grant-tendering scheme, government should establish a market where abatement through green carbon can be verified as genuine, and where businesses will use these options to reduce emissions if they prove efficient and profitable, and reject them otherwise. We should let the market decide.

John Daley is the chief executive, and Tristan Edis is research fellow, energy, at the Grattan Institute.

John Daley
CEO, Grattan Institute
Contact: 03 8344 6142 or john.daley@grattan.edu.au

Tristan Edis
Research Fellow, Grattan Institute
Contact: 03 9035 8186 or tristan.edis@grattan.edu.au

www.grattan.edu.au