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Pain of carbon protectionism

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*Claims for carbon price assistance signal a new era of protectionism, write, **Tony Wood and Tristan Edis.***

The federal government's climate change plan grants generous financial assistance to industries that claim the introduction of a price on carbon will hurt their business when they have to compete with overseas rivals that don't face the same cost.

We reviewed the assistance proposed to three emissions-intensive industries: coalmining, liquefied natural gas (LNG) and steel. We found that even allowing for recent economic changes such as the effect of the high Australian dollar, the level of protection that the government proposes is costly and unjustified.

We call it "new protectionism" because the bearer of the cost of special treatment for a few industries will be the entire Australian community. Even when it has to pay \$40 a tonne of carbon it produces – a price well above the likely level out to 2020 – LNG will be profitable. Existing facilities are likely to maintain and even expand production; new projects are likely to commence.

Our analysis of the Australian coal sector, using publicly available information, indicates there will be no overall loss of production. For both thermal and coking coal exports, Australia's competitive position is so strong that they are unlikely to be materially disadvantaged.

Both these industries are forecast to expand substantially over the next two decades, and LNG is forecast to more than double its emissions in the next 10 years. If Australia is to meet its carbon reduction targets, other industries will have to reduce their emissions more, and at higher cost, to compensate for the LNG and coal industries emitting more. It would seem unfair for LNG and coal to be overly compensated for a carbon price in such circumstances.

Steel is in a different position from these two industry sectors. Recent shifts in global steel prices and exchange rates have substantially reduced the profitability of the Australian steel sector. These changes may well be structural and long-lasting.

In 2008, the government proposed an allocation of free permits to steel to ensure that carbon pricing in Australia did not drive production overseas with no climate benefit. In 2011, the proposed assistance in the package and draft legislation will leave the steel industry better off than it would have been without a carbon price. Industry assistance, camouflaged as carbon pricing relief, should not be used to delay structural shifts that are inevitable.

The main legitimate rationale for assistance to emissions-intensive, trade-exposed industries is to prevent carbon leakage: where a carbon price forces industry to shift production to other countries without a reduction in global emissions. But the draft legislation appears to have dropped the need to prevent carbon leakage as its rationale for providing assistance in favour of one based on preserving equivalent government burdens and benefits between Australian industry and its competitors.

This is not the right approach.

In July, we welcomed the release of the federal government's clean energy future climate change package. But at that time we were concerned the package provided substantial free permits not only to trade-exposed industries but to electricity generators and other industries that do not need assistance. That is why we saw the proposed role for the Productivity Commission to investigate the continuing need for this assistance as critical. Unfortunately, our review of the draft legislation indicates that it excessively limits the commission's scope to review protection, because it cannot apply a true carbon leakage test.

The climate change package represents a difficult political compromise. It has been subject to intensive, and to date, successful lobbying from major industries. The level of assistance is unjustified by generally accepted economic principles – and the loser will be the Australian community.

The draft legislation should be amended to embed the principle of rigorous review by the Productivity Commission. If that happens, we can still hope that the battles of the 1980s and 1990s to end protectionism will not have to be fought by a new generation.

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