Business will have to live with CO_2 price

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*Companies cannot expect any free kicks from the government, writes **John Daley.***

The reality is dawning that companies really will start paying for carbon emissions on July 1. Some electricity generators are again calling for governments to reduce the burden.

They will need to be lucky. The Gillard government still needs the support of Greens in both houses of Parliament. The government is politically committed to a balanced budget, and is counting on the legislated carbon price revenue.

Bringing carbon pricing legislation back before Parliament would reopen a difficult debate for little gain. The government is likely to hold its nerve, as it has little choice.

In fact, the most likely next change in carbon emissions policy will be to tighten requirements. This is contrary to expectations in many quarters, but it is the logical consequence of the predictable impact of carbon pricing.

As chief financial officers start to sign cheques for their carbon emissions, they will doubtless also consider how they can reduce the bill. The bean counters will probably come to the conclusion that any capital outlay of less than $87 that reduces emissions by one tonne a year is a good idea.

Australia's carbon price law provides a fixed price of $23 to $25 over the first three years, then a minimum price of $15 to $17 for years four to six. After then, who knows? But six years is an eternity for much corporate financial decision-making.

Applying a 15 per cent cost of capital, the present value of the first six years of carbon pricing is at least $87 a tonne of emissions.

There's upside if the traded price is higher than the floor price, or if the scheme continues for more than six years. Of course, there is a possibility that a future Abbott government might eventually repeal the carbon price. But the constitutional requirements for a double dissolution process make repeal unlikely within three years.

A tonne of annual emissions will cost $62 over these three years.

It is likely that companies will find a lot they can do for $87 a tonne.

They might use more fly ash and less cement in concrete, use less energy to make bricks, or turn the lights off after hours. It is likely that engineering consultancies have been working through the options.

As carbon pricing approaches, their clients will get more serious about putting the options into practice. History suggests that over time, the business reaction is likely to be greater than anticipated. Pollution pricing schemes tend to be much more effective than official forecasts.

After about two years in most fixed emissions schemes, prices were invariably much lower than forecast. The two-year lag may reflect the two-year cycle for businesses to devise, prioritise, staff, and implement projects.

Over the next six years, Australia has in effect fixed the price rather than the volume of emissions.

John Daley, Chief Executive Officer
T. 03 8344 6142 E. john.daley@grattan.edu.au

Consequently, the volume of emissions is likely to be less than forecast. As well as carbon pricing, there are other drivers of reduced carbon emissions. Australian total electricity use has declined in the past two reported years.

Electricity price rises are likely to reduce emissions further. After decades of real price decline, Australian electricity prices are now rising quickly. This is primarily the result of rising gas prices, construction prices, and investments in the grid to support peak usage.

If emissions are less than forecast, the budget will be a problem. Carbon price revenues will be less than forecast. But the costs associated with the carbon package will be the same. Thus the most likely outcome of the reality of carbon pricing is that Australia will emit less carbon than forecast, and reducing emissions will cost less than many have claimed.

But the commonwealth will be looking for additional revenue.

The obvious way to fill the budget hole will be to reduce permitted emissions, and reduce eligibility for free permits. Those calling for reduced carbon price burdens are unlikely to be heard. They would be better off figuring out which investments reduce emissions for less than $87 a tonne.

John Daley is chief executive of Grattan Institute.

www.grattan.edu.au

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