

## SUBMISSION TO CARBON POLLUTION REDUCTION SCHEME - GREEN PAPER

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## *CCBR Response to* **“Carbon Pollution Reduction Scheme Green Paper, July 2008”**

### *Abstract*

*Climate Change Balmain-Rozelle makes proposals regarding these concerns:*

- *Lack of a target for 2020*
- *Insufficiently ambitious target for 2050*
- *Methods of compensation that weaken the incentive to reduce emissions*

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## **Introduction**

### **Who are CCBR?**

*CCBR (Climate Change Balmain-Rozelle) is an independent collective of residents in the Balmain/Rozelle area of Sydney who share concerns about the threat from climate change, focusing mainly on emissions from power generation. CCBR is a volunteer group that is not funded or steered by any private or government body or political party.*

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*<http://cana.net.au/>*

## Purpose of this document

This document is CCBP's submission in response to the Rudd Government's July 2008 Green Paper "Carbon Pollution Reduction Scheme."([ ]). A longer version, including brief sections on Transport and Agriculture, has already been contributed towards CANA's official response. Those sections are omitted here because of the limited mandate implied by CCBP's published platform.

## Target Levels

We believe that 40% of 2000 levels at 2050 is still dangerously high and that an earlier aggressive target is needed. Establishing intermediate targets soon is essential for informing decisions on the investment of R&D.

For example, CCS may be useful for achieving the 2050 target but unable to assist with earlier targets. See the discussion "'Clean' coal" in 'Chapter 20 of [ ].

Ambitious though it may seem, we propose:

- **2010: Peak emissions**
- **2020: No more than 40% of 2000 level; stretch goal of zero emissions**
- **2030: Zero emissions**

## Compensation and the Incentive Principle

While we accept the need to soften the economic impact for various industries in the short term, the manner of doing so is critical.

Compensation which is tied directly to the actual impact, such as free or cheaper permits, is inherently flawed, as it destroys the incentive to develop less harmful modes of production. It would be better to compensate in proportion to production. This could be based on some percentage of historic emissions per unit of production, or better still, on current international best practice for the industry. The percentage would start at less than 100% and reduce over time.

Example:

A company produces widgets by a process which emits some amount of CO<sub>2</sub>e per widget. At the current price of permits, that adds \$1 to the \$10 cost of a widget.

The Government currently rebates 60% of the cost of permits for widget production.

An alternative technology is available which adds 25c to the production cost of a widget but reduces emissions by 50%.

Without the rebate, the company would calculate:

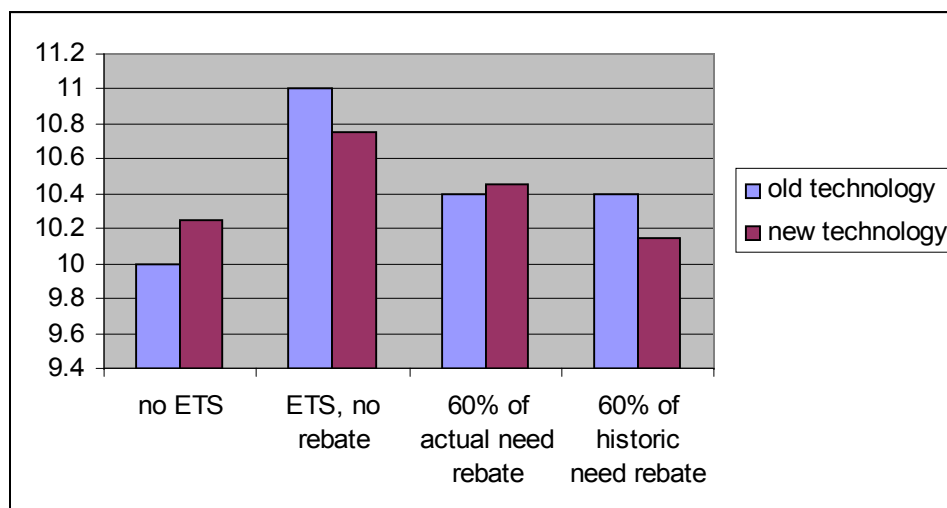
- Current technology: extra cost = \$1
- Alternative technology: extra cost = 25c + 50% × \$1 = 75c

Result: company adopts cleaner technology to save money.

With the rebate, the company calculates:

- Current technology: extra cost = 40% × \$1 = 40c
- Alternative technology: extra cost = 25c + 50% × 40% × \$1 = 45c

Result: adopting the alternative technology cuts the rebate from 60c to 30c, leaving no incentive.



**Figure 1: Incentive and Rebates, Example**

Now suppose that instead of the rebate being 60% of the actual ongoing need for permits it is fixed at 60% of permits needed using current technology. This means that the alternative technology can be adopted and still reap 60c rebate per widget.

- Current technology: extra cost =  $\$1 - 60c = 40c$
- Alternative technology: extra cost =  $25c + 50\% \times \$1 - 60c = 15c$

Application of this *incentive principle* will be treated in more detail in the ensuing sections.

## International Trade (EITEs)

This aspect is the greatest threat to the effectiveness of CPRS.

### International Trade Agreements

Of particular concern are restrictions imposed by existing international trade agreements. (See Box 9.2 in [1].) These make it more internationally acceptable to compensate industries in direct proportion to the increased costs arising from CPRS than to compensate in ways which satisfy the incentive principle.

On the other hand, the WTO's published position ([2]) implies that there is some room for manoeuvre:

*"The [TBT] Committee looks at climate change measures to ensure they do not pose unnecessary obstacles to international trade, while still achieving the legitimate objective of protecting the environment,"*

We urge the Government to push for international compensation mechanisms that satisfy the incentive principle. If unsuccessful, the Government should be prepared to flout the WTO.

### Proposed Assistance schema

Box 9.5 of [1] proposes a two-tier assistance rate:

t CO <sub>2</sub> -e / \$M revenue	Assistance rate
0-1500	0
1500-2000	60
> 2000	90

**Figure 2: Assistance rates proposed in Green Paper**

Such sudden steps may be administratively convenient but create unfortunate anomalies. A firm lying just below a threshold may find it advantageous either to increase its emissions or to reduce the price of its product so as to boost the emissions per dollar of revenue over the threshold. A smoother relationship should be manageable.

To satisfy the incentive principle, we recommend that, for the purposes of this schema, the emissions/\$ be based on current international best practice for the industry, not on actual emissions/\$ for the specific entity. This is for both direct and indirect emissions, treated as a total.

## Strongly Affected Industries

### Eligibility

The definition of an entity eligible for relief under SAI provisions in Box 10.1 of [] includes the condition that:

*its ability to pass on costs is constrained by domestic competitors that face no commensurate increase in costs as a result of the scheme*

To compensate modes of production in proportion to their environmental unfriendliness defeats the object. It would be especially unfortunate if this clause were to allow brown-coal power stations to continue to operate.

The ensuing text then extends this to entire industries where there is a high price elasticity of demand:

*... (that is, if a given rise in price induced by the scheme will result in a relatively large reduction in demand), then the industry will be unable to pass a significant portion of its carbon costs through to consumers.*

Supporting industries which simply would not exist in a world where the true costs of production are passed to the consumer is not appropriate.

### Form of Assistance

According to [],

*The Government seeks stakeholder feedback on the relative merits of providing direct assistance to coal-fired electricity generators through allocations of carbon pollution permits or cash payments.*

It follows from the considerations in () that the form of assistance should in no way tend to perpetuate the mode of production. Therefore we recommend instead 'weaning' arrangements which provide a one-time compensation for sunk cost and/or for leaving the industry. Suitable precedents exist in the *Securing our Fishing Future* package and the Dairy Exit Program.

### Cut-off date

On the basis of carbon trading becoming a bipartisan policy in Australia on that date, [] proposes June 2007 as a cut-off date for sunk cost eligible for compensation. While it is certainly a reasonable point at which to terminate eligibility totally, it fails to give appropriate recognition to those firms which faced up to their responsibilities sooner. There are many earlier dates which justify at least a partial cut-off.

The awareness of the dangers of CO<sub>2</sub>'s greenhouse property began with Jean-Baptiste Fourier in 1827. During the 1970s, a growing body of scientists began to point out the trends and warn of the consequences. In 1985, a major international conference of climatologists at Villach, Austria, warned of up to a one metre rise in sea levels by 2050. By 1990 it had become a matter of public debate, and in that decade such conservative institutions as insurance companies pushed for the threat to be taken seriously. In short, no leader of a major industrial concern could plead ignorance beyond the start of 2000.

In 2001, the IPCC, despite all the political pressures and inherent conservatism, announced that on the balance of probabilities humanity faced the prospect of severe global warming. The industries highlighted must have been well aware of the implications since they had already started to lobby governments, challenging the science.

We therefore propose a sliding scale in which the value of the compensation for sunk cost declines steadily from the date of that IPCC report.

### **Example**

Here is an example of how the above considerations might be applied. For simplicity, inflation is ignored.

In 2002, the Black Bull Electric Power Company constructed a coal-fired station at a cost of \$50m. In 2004, a \$10m upgrade boosted the output. At current production and permit price, CPRS will cost the plant \$1m/year.

The base compensation is 90%, but since the original \$50m was spent 1/6 of the way through the 2001-2007 window, only 5/6 of that is eligible. Similarly, only 1/2 of the upgrade is eligible. So the actual compensation is  $((5/6)(5/6)+(1/2)*(1/6))*90\% = 70\%$ , or \$700K p.a.

Two years later, the company opts to cut generation at this plant by 20%, substituting power from a zero-emissions plant. This does not reduce the compensation dollars since the output is the same. While this may seem like a windfall to the company, it is necessary to drive the switch to zero-emissions.

Meanwhile, the retail price of electricity has increased in real terms, so the Government drops the base compensation rate for the industry to 81%. The compensation for Black Bull therefore drops to \$630K p.a.

In 2003, the White Charger P.C. constructed a zero-emissions plant with one tenth of the output of the Black Bull plant. Even though they need not buy any permits, they are still entitled to  $(2/3)*100K$  p.a. = \$67K p.a. Again, this appears to be a pure windfall, but is justified on two grounds. The same outcome could be effected by shutting the plant and selling it to Black Bull, who then reopen it transferring production as above. Secondly, disallowing such windfalls sends the wrong message to industry, encouraging companies to resist being good corporate citizens until the carrot is large enough.

### **Terms and acronyms**

*CCS* Carbon Capture and Storage

*CPR* Carbon Pollution Reduction Scheme

*S*

*EETS* European Emissions Trading Scheme  
*EITE* Emissions-Intensive Trade-Exposed  
*SAI* Strongly Affected Industry

## References

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2. Spratt, David & Sutton, Philip (2008) *Climate Code Red*. : Scribe. ISBN (13): 9781921372209
3. [http://www.wto.org/english/tratop\\_e/envir\\_e/climate\\_measures\\_e.htm](http://www.wto.org/english/tratop_e/envir_e/climate_measures_e.htm)