An Evaluation of the Report of the Australian Prime Minister's Task Group on Emissions Trading

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- The Australian Prime Minister's Task Group on Emissions trading submitted their final report to the Prime Minister at the end of May 2007

- The Task Group Approach (TGA) marks an important new stage in the climate policy debate in Australia

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Overview

- The Context
- The Task Group Approach (TGA) - a philosophical shift from the Kyoto Approach
- Some (implementation) differences between the TGA and the McKibbin Wilcoxen Blueprint (MWB)
  - Credibility of long term goal
  - Allocation of permits
- What remains to be done?
- Conclusion

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The Context

- Australia was vulnerable under the Kyoto Approach of targets and timetables that ignored potential cost
- The government rejected Kyoto but did not have a comprehensive alternative – R&D and specific subsidies were understood not be comprehensive enough
- Debate domestically and internationally was difficult because of the “Kyoto is the only game in town” mantra

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The Context

- Kyoto countries began realizing that many would not reach their Kyoto targets
- Industry wanted clarity on what carbon policy would follow Kyoto
- Developing countries refused to take on binding targets and timetables (largely because of unknown costs)
- The science of climate change became more compelling with the Stern Review and the IPCC reports stressing need for action and deep cuts.

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The Context

- The Prime Minister's Review of Nuclear Energy put carbon pricing at the forefront of the debate on which technologies might reduce the carbon footprint

- Political pressure mounted on the government to take action due to the drought and increased awareness of the climate change issue

- There was a need to offer an alternative beyond Kyoto – and the Brookings research was ready for consideration

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TGA is not Kyoto

- Kyoto
  - is a targets with timetables strategy –clear targets over time independent of the costs of reaching them
  - is a centralized global approach

- TGA
  - sets goals for emission reductions with the timetable not specified exactly with policy steering emission reductions towards the goals based on the observed costs over time
  - is a national to global approach

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What Australia Should Focus on*

- “engaging the top emitters
- providing flexibility to reflect different national circumstances
- addressing competitiveness issues
- coupling near-term action with a long-term focus
- integrating climate change, energy security and sustainable development policies
- addressing the need for adaptation to the impact of climate change
- delivering a politically acceptable equity formula.”

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* Page 60 of the Report

The Details of TGA

- **a** long-term aspirational emissions abatement goal **and associated gateways to provide a context for community efforts**
- maximum practical coverage **of all sources and sinks, and of all greenhouse gases**
- **a system of permit allocation and issuance**
- **a** 'safety valve' **emissions fee designed to limit unanticipated costs to the economy and to business**
- **recognition of a wide range of credible domestic and international** carbon offset **regimes**

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The Details of TGA

- **capacity, over time, to** link to other national and regional schemes **in order to provide the building blocks of a truly global emissions trading scheme**

* Page 99 of the Report

How TGA works versus the MWB

The Task Group Approach

- Require emitters to have an annual emission permit
- Create packages of date stamped permits out to perhaps 40 years (medium term permits)
- Allocate some of these medium term permits to affected industries
- Auction some – keep the rest for future allocation

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The Task Group Approach

- Trade the allocated permits in a market with a futures market trading future permits
- Allow emitters to pay a “safety valve” penalty if they don’t have enough permits in a given year
- Every 5 years assess whether to auction more medium term permits

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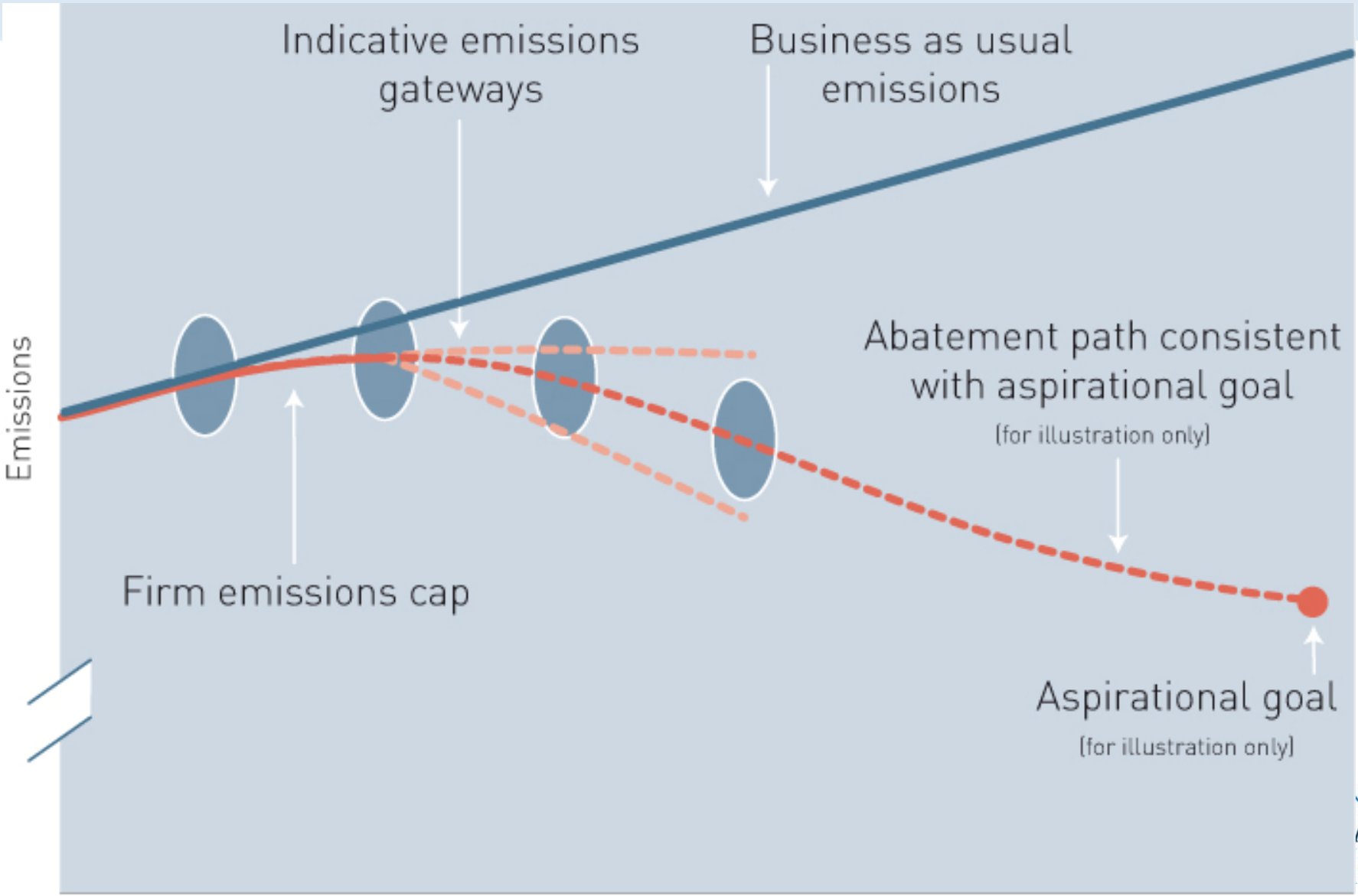
Figure 7.1 Illustrative emissions trajectories



Source: ETR page 101

Figure 7.2 Illustrative price paths for carbon permits and the emissions fee

Source: ETR page 101

McKibbin Wilcoxen Blueprint

- Require emitters to have an annual emission permit
- Create long term permits that give a declining permit each year for 100 years
- Allocate all of these long term permits to affected industries and households
- Trade the allocated permits in a long term market (this is a futures market)

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McKibbin Wilcoxen Blueprint

- Trade annual permits in the annual market
- Allow emitters to buy “safety valve” annual permits at a fixed price from the government if they don’t have enough permits in a given year
- Every 5 (or 10) years assess whether to change the safety valve price for the next 5 years

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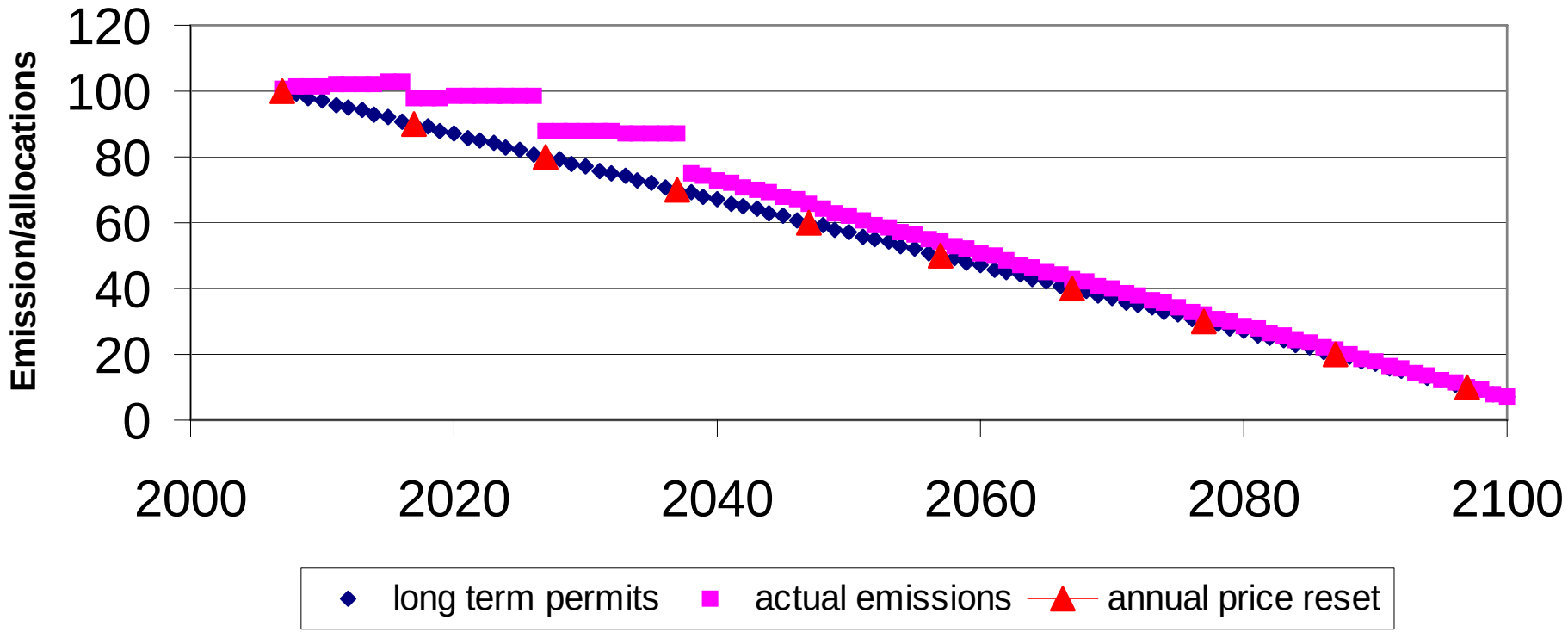
Emissions and Long Term Permits in Australia



Source: McKibbin Wilcoxen Blueprint

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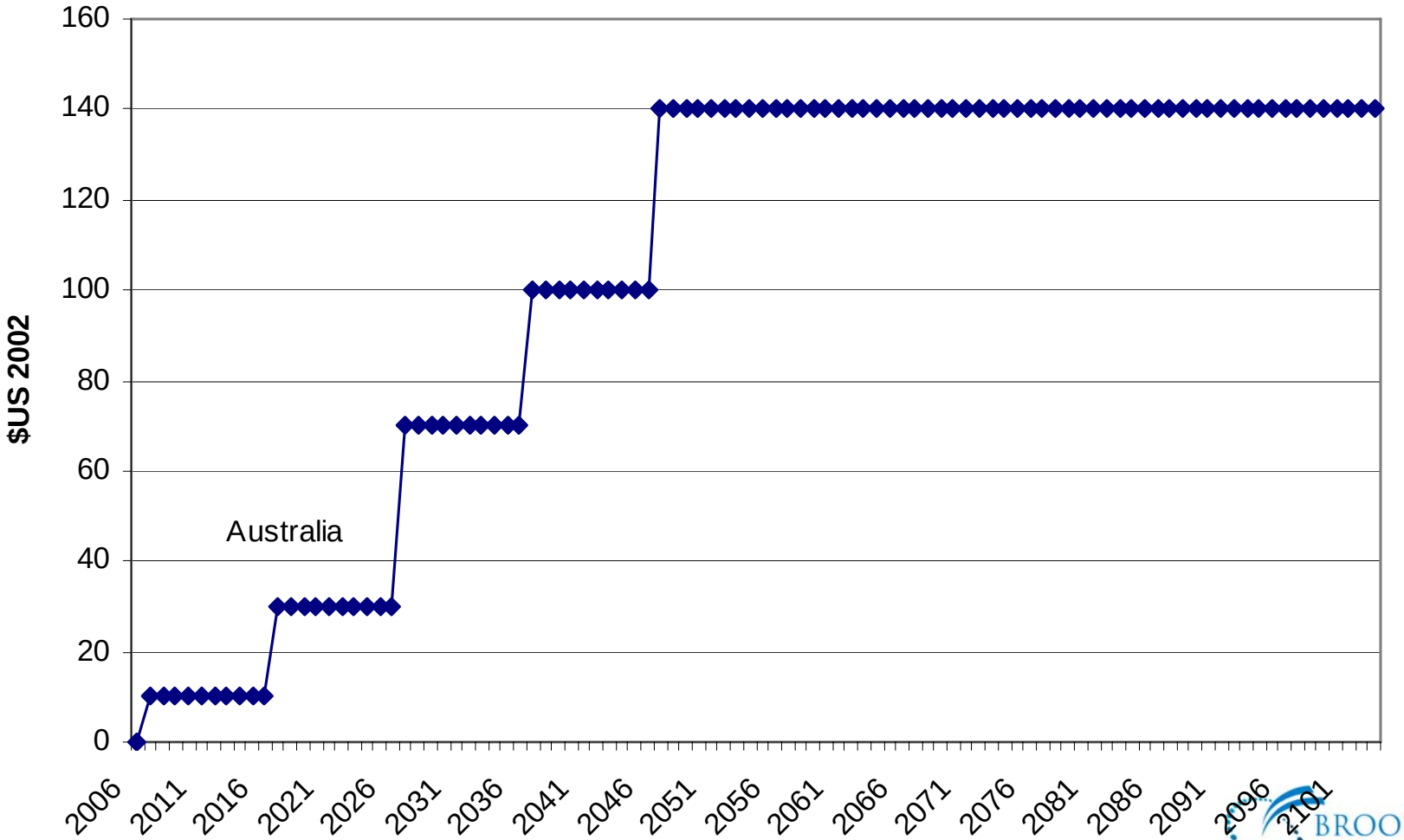
Figure 5: Annual Permit Price



Source: Author's Calculations

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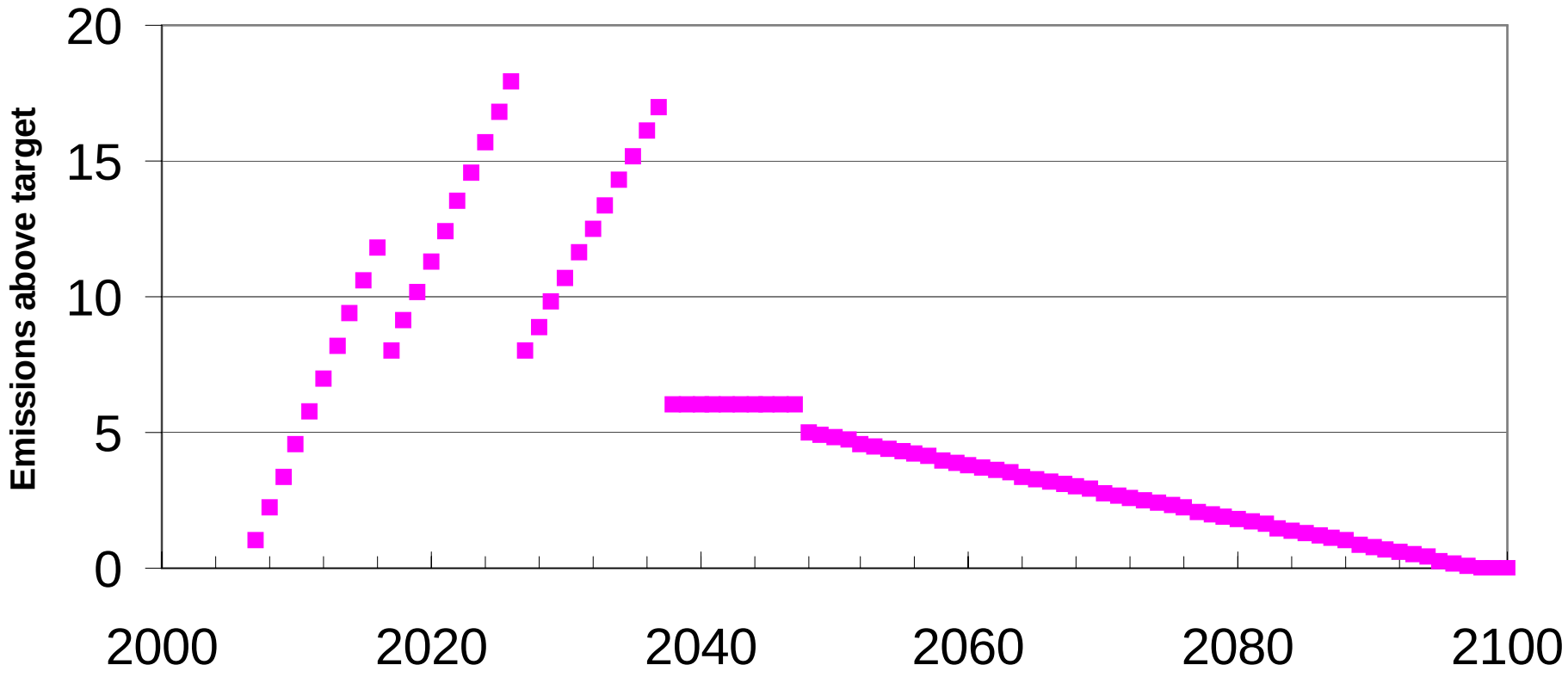
Source: McKibbin Wilcoxen Blueprint

Annual permit Sales - Australia



Source: McKibbin Wilcoxen Blueprint

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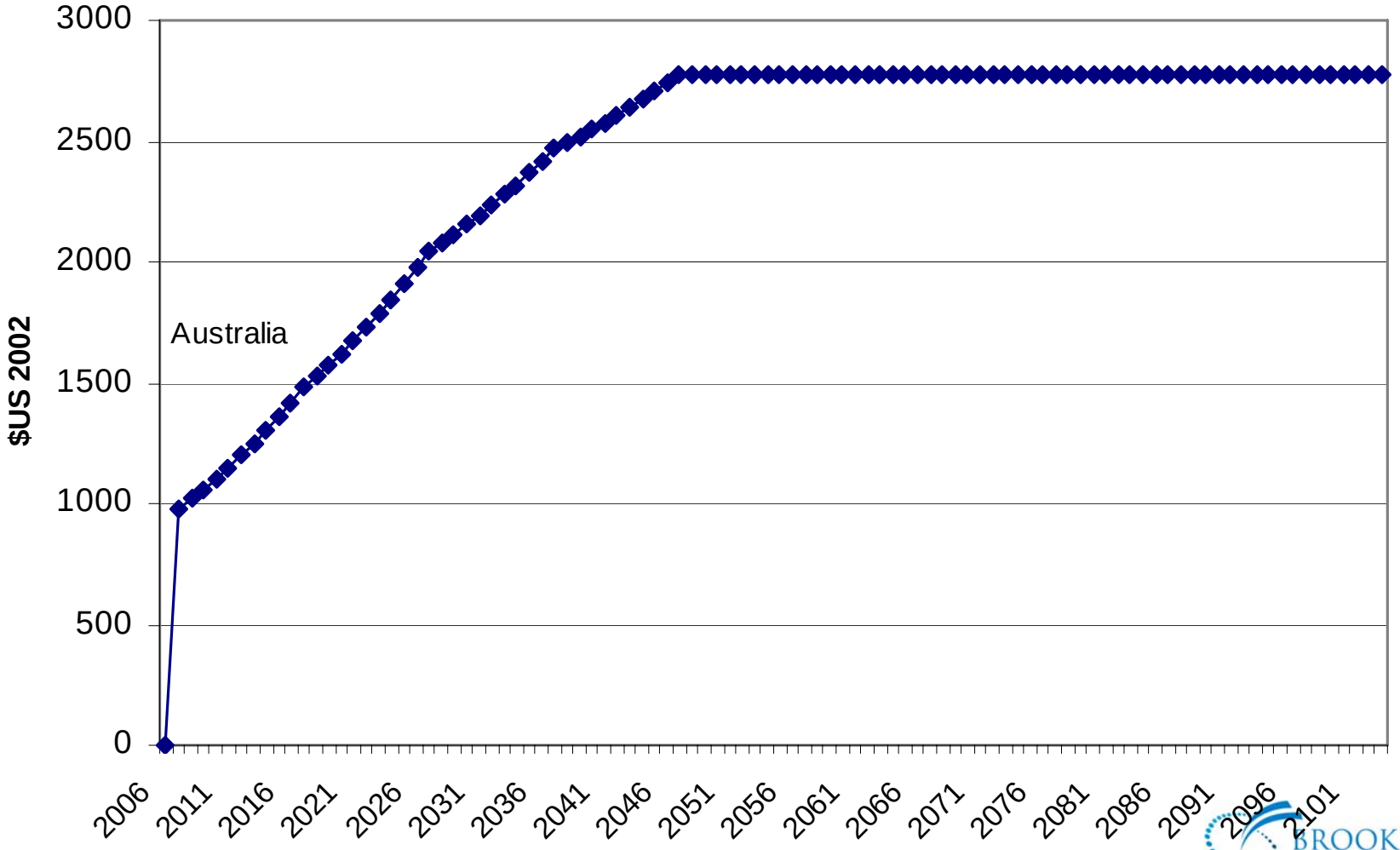
Figure 6: Value of Long Term Permits (r=5%)



Source: Author's Calculations

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Source: McKibbin Wilcoxen Blueprint

Key difference

- Long term “aspirational goal” is less credible than issuing long term tradable property rights
- Two step process rather than 3 steps
- MWB is a better approach for implementing in developing countries

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Credibility of Future Price

- The current carbon price drives economic costs; the future price of carbon drives technology
- A rising future price critical for encouraging emergence of emission reducing technologies
- Re-issue of medium term permits potentially undermines the long term goal

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Issues about Allocation

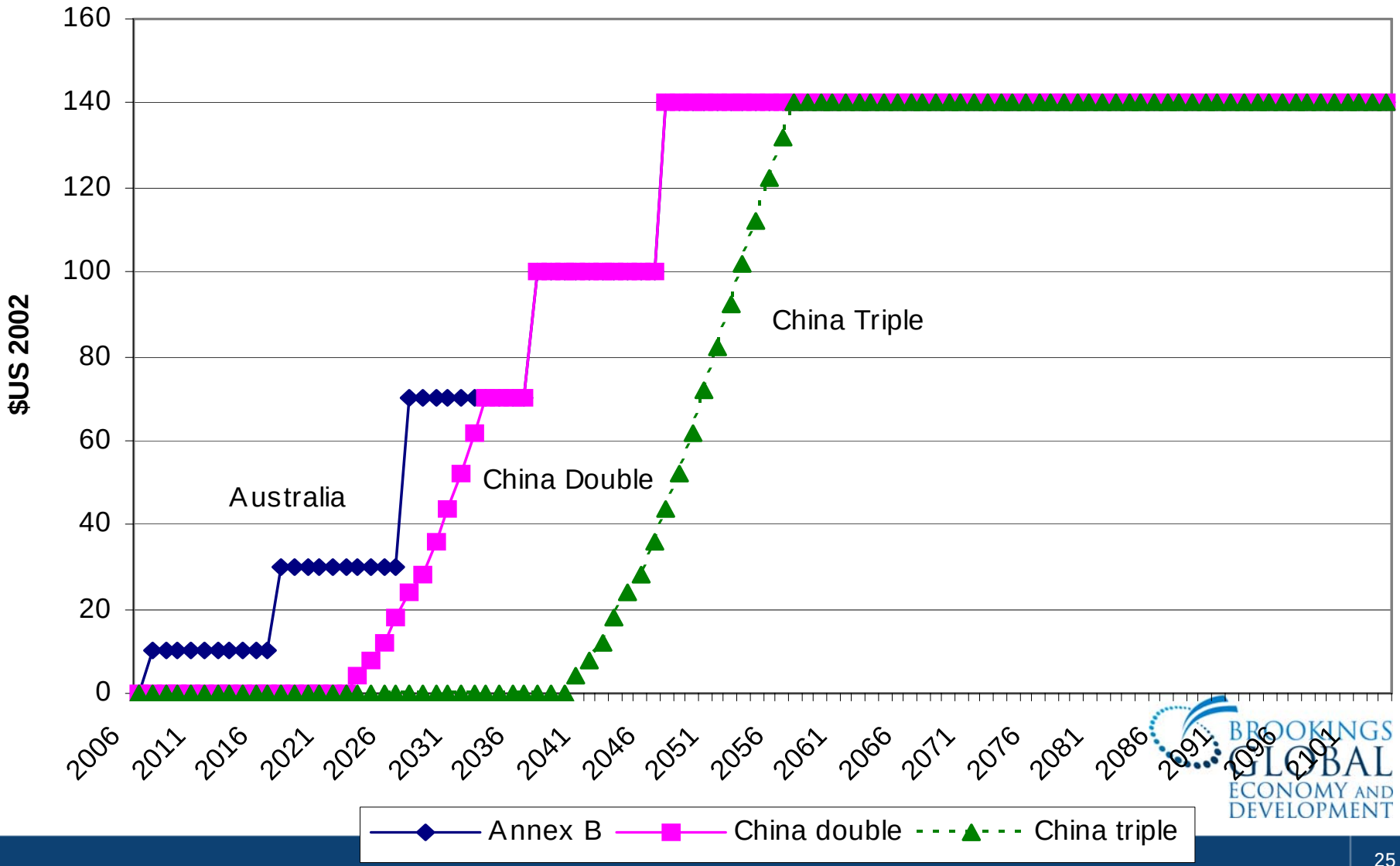
- In TGA a bundle of emission permits of different durations are given to exposed industries and the remainder auctioned

- In MWB all long term permits are given out at the start – half to industry and half to households

Application to Developing Countries

- Consider an example in which China commits to a larger allocation of long term permits than current emissions (twice versus three times)

Figure 5: Annual Permit Price



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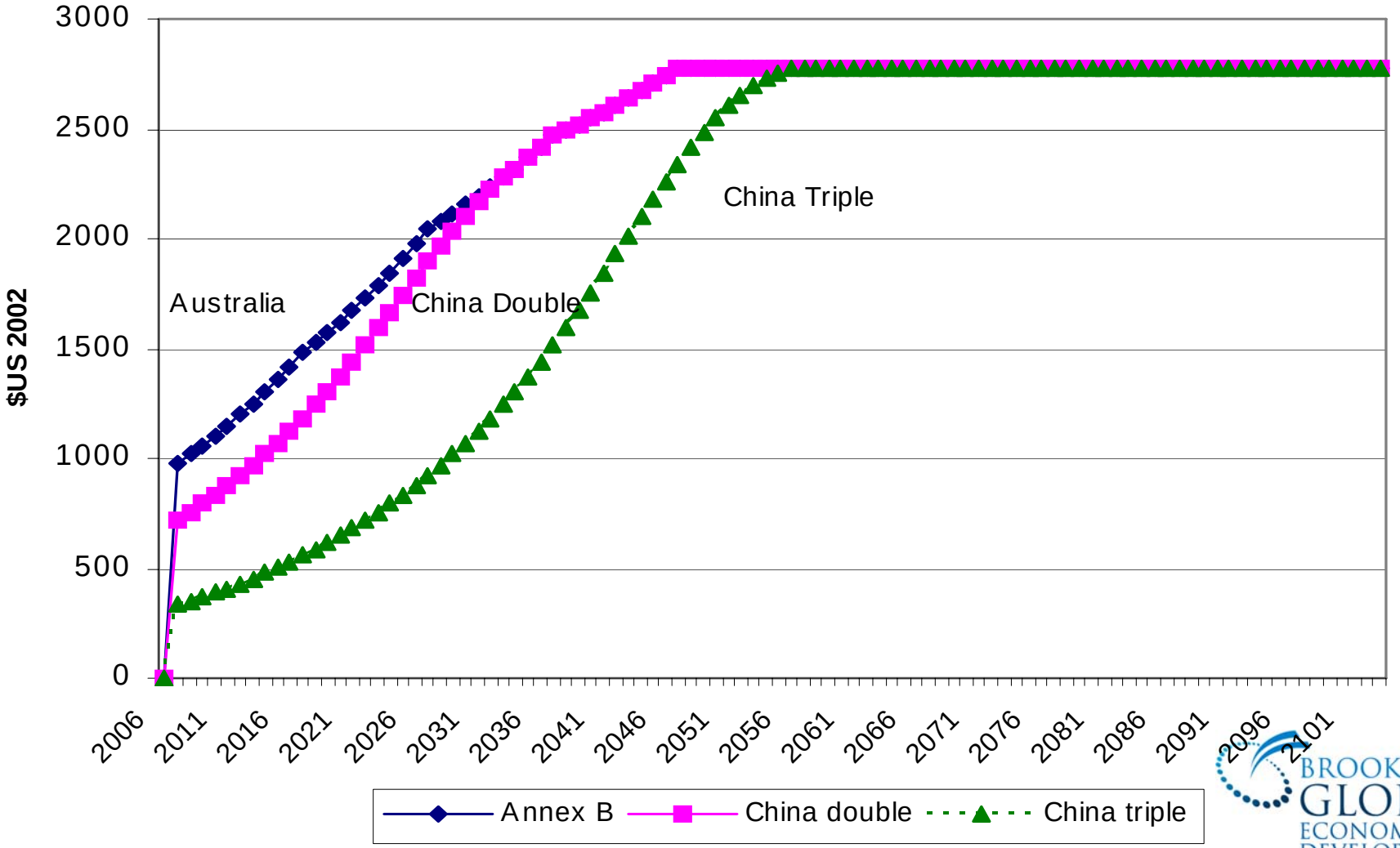

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What is left to do - Build Bipartisan Support

- Climate policies are converging across the political spectrum
- Labor (Opposition) has a medium term target and timetable
- TGA recommends a long term aspirational goal with large amount of flexibility over time
- Both approaches can be made to work within the broad MWB approach

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Conclusion

- TGA is an important document that shifts the debate away from the Kyoto style policy of targets and timetables towards innovative ways to price carbon but minimize short term economic cost

- There is now a credible new approach on the table that countries, who have rejected targets and timetable, can adopt and countries that have binding but infeasible Kyoto targets but can consider for the period beyond 2012

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Background Papers

www.sensiblepolicy.com

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