

5 January 2014

The 'Direct Action' Approach to Climate Change

John Hawkins

Introduction: the 'tender' approach

The Government, in its *Green Paper*¹, appears to have abandoned some of the aspects of its so-called 'direct action' scheme taken to the 2010 and 2013 elections. But what remains is still a sketchy outline of an approach which will be much more expensive than an emissions trading scheme, unfair and highly unlikely to achieve emissions reductions consistent with Australia making a fair contribution to keeping global greenhouse gas emissions below levels consistent with global average temperatures not more than 2 degrees above those prevailing in the pre-industrial era. To use this flawed and sketchy scheme as justification for removing the market price on carbon would be to subsidise polluters, to betray future generations and to set a bad example to the rest of the world.

The new Abbott Government claims to share the emissions target of the former Labor government, which it sometimes interprets as a 5-25 per cent reduction in emissions², but more often characterises as a promise to "reduce CO₂ emissions by 5 per cent by 2020 based on 1990"³ or "reduce Australian emissions to five per cent below 2000 levels by 2020"⁴. It claims that it can achieve this without a carbon price through a 'competitive grant programme' which seeks to reduce emissions by companies putting in 'tenders' for actions that reduce greenhouse gas emissions and the government then paying those companies making the best/lowest bids (per tonne of abatement).⁵

The Government will establish an Emissions Reduction Fund to pay the successful tenderers. The hope is that (ignoring for now administrative costs) such a tendering scheme could put a 'price' on carbon and lead to the least expensive abatement projects going ahead. But there are many implications of even a pure version of such a scheme that have not received much public discussion, which raise doubts about its effectiveness and fairness and may erode support for such a scheme;

¹ Australian Government Department of the Environment, *Emissions Reduction Fund Green Paper*, December 2013.

² The Department of the Environment's website (accessed 7 November 2013) says Australia will, under the Cancun agreements "unconditionally reduce its emissions by 5 per cent" and by up to 15 per cent if there is a global agreement involving "major developing countries commit to substantially restraining their emissions and advanced economies take on commitments comparable to Australia's".

³ Liberal Party, *The Coalition's Direct Action Plan*, downloaded from the Liberal Party of Australia's website, (<http://www.liberal.org.au/~media/Files/Policies%20and%20Media/Environment/The%20Coalitions%20Direct%20Action%20Plan%20Policy%20Web.ashx>, downloaded 24 July 2011), p 1.

⁴ *Green Paper*, p 1.

⁵ As Greg Hunt put it; "the [coalition] government will simply buy back the lowest cost abatement"; opinion piece in *Australian Financial Review*, 24 October 2011, p 55. As Tony Abbott put it, "you go to the market and you say look, we are looking to buy cost effective emissions reductions"; interview with Ian Henscke, 7 March 2011, Tony Abbott's website.

- tendering for emissions reduction would be most attractive to a company with a marginally profitable facility (eg a steelworks or a car manufacturing plant struggling to compete with the \$A at a high level) that could be closed. The scheme would then mean that taxpayers' money is being used to put people out of work;
- a multinational could successfully tender by committing to reduce production and hence emissions in Australia but to increase them overseas;
- there could also be a domestic 'carbon leakage' if the output of a firm successfully tendering to reduce its production and hence emissions is just replaced by increased output by another domestic firm (or another plant owned by the same firm)⁶;
- a company that has been operating inefficiently and polluting a lot has much more scope to put in a tender than a responsible firm that has already taken action to minimise its emissions. The scheme therefore penalises past good behaviour and rewards bad behaviour;
- the scheme requires the government to raise more tax revenue than it would otherwise need and then make payments to polluters. It therefore increases the 'churn' in the tax system. Those concerned with efficiency costs from taxation should prefer a scheme where a carbon price *replaces* some income tax collections (as is the case with the Clean Energy Future package);
- the cost of the scheme is borne by taxpayers and the benefits are received by the polluters;
- it gives no incentives for consumers, and firms not making successful tenders, to seek out ways of using energy more efficiently and provides little encouragement for the development of renewable energy; and
- as it only runs to 2020 it does not provide incentives for longer-term measures.

The Coalition initially claimed that the Fund will support 140 million tonnes of abatement per annum by 2020, aiming at a target of total emissions of 525 million tonnes of CO₂ equivalent per annum by 2020.⁷ Mr Hunt later increased the amount of abatement claimed for the scheme to 155 million tonnes, but without changing his estimates of the cost.⁸ In the *Green Paper* the amount of abatement in 2020 is put at 131 million tonnes.⁹

Practical details of the Government's plan

The Government has described their plan as involving "businesses reducing their emissions below their individual baseline ('historical average')".¹⁰ This seems to suggest a firm with a project to reduce the amount by which their emissions would otherwise increase would not be eligible. At other times there are references to reductions in "business as usual" emissions, which may allow for some trend growth in emissions, however calculated.¹¹ The historical averages will be calculated

⁶ The Investor Group on Climate Change warned of this possibility; *Senate Select Committee on Scrutiny of New Taxes Hansard*, 23 September 2011, p 291.

⁷ *The Coalition's Direct Action Plan*, pp 1, 13.

⁸ Greg Hunt, 'Speech to Carbon Expo Australia – Clean Energy without a carbon tax', 10 November 2012. His only explanation is 'my judgement is that there will be more abatement available at a lower cost than our original estimates'.

⁹ *Green Paper*, pp 1 and 8. The lower figure now apparently reflects a "carryover of surplus Kyoto credits". (p 11).

¹⁰ *The Coalition's Direct Action Plan*, p 14.

¹¹ For example, remarks by Greg Hunt cited in *Australian Financial Review*, 9 March 2013.

from existing reports under the National Greenhouse and Energy Reporting Scheme (NGERS). The Green Paper says “emissions from past practices can be determined using existing historical data for a single year or several years”.¹² It is not clear whether this means the Government has not decided on the approach required or whether individual firms can choose the method that best suits them.

Businesses not currently reporting under NGERS will also be able to bid, but it is not clear how their baselines will be assessed. Nor is it clear how a new firm would be treated as they do not have a baseline to go below. Some companies may have substantially changed the nature of their operations, selling or buying individual plants or changing what they produce so that their previous baselines may not be relevant to their current operations. There are also complications around the treatment of a firm whose emissions are temporarily low during the baseline period due to maintenance, flooding or industrial disputes leading to temporarily lower production.¹³

The bids have to be for projects that would not otherwise proceed.¹⁴ This creates a serious problem for a firm that submits an unsuccessful bid to reduce emissions. It then cannot later undertake that action that would reduce emissions because that could be seen as indicating it had made a false claim in its bid. So the scheme will actually *prevent* many firms from reducing emissions.

Even in the *Green Paper* there is very little detail about how the scheme will work in practice. The auctions are to be held “at regular intervals” but it is not stated how frequent they will be.¹⁵ Indeed the supposed regularity is called into question as it is said that “auctions would take place several times a year, depending on the supply of projects”¹⁶ and “there is likely to be a need for flexibility in setting the auction schedule”¹⁷. And auctions will only be held once an (unspecified) minimum number of bidders have registered.¹⁸

A new feature introduced in the *Green Paper* is a secret benchmark price which would be the highest paid.¹⁹ This seems a big move away from the idea of a simple and transparent auction process. It is not clear how this benchmark will be set. If it is too low then few or no bids may be accepted and so the scheme will achieve no or little reduction in emissions. If it is set too high it will be non-binding and irrelevant. It introduces further complex tactical considerations for bidders. If the benchmark is expected to be lowered over time there could be an incentive to rush to submit an early tender. But if a lot of firms are expected to tender early then the price could be low in early rounds which provides an incentive to tender later. If the benchmark is expected to be fairly constant will the optimal strategy for bidders be to put in a high bid at the first tender and if unsuccessful gradually lower the bid at successive tenders?

Another new, vaguely described, feature introduced in the *Green Paper* is a separate tender process for (undefined) “very large projects”.²⁰ There is also a reference to the Fund including a “framework to ensure new investments are encouraged at best practice”.²¹

¹² *Green Paper*, p 26.

¹³ The *Green Paper* acknowledges that “where businesses have suffered from impairment or abnormal effects, this can and should be normalised” (p 27) but suggests no means of doing so.

¹⁴ This is the concept known as ‘additionality’; *Green Paper*, p 2.

¹⁵ *Green Paper*, p 4.

¹⁶ *Green Paper*, p 4.

¹⁷ *Green Paper*, p 57.

¹⁸ *Green Paper*, p 30.

¹⁹ *Green Paper*, pp 4 and 29.

Policy certainty and long-term investment

The scheme does not provide the certainty that business claims they need to make their investment plans. It can be "amended to reflect the approaches taken by our major trading partners and big global emitters".²² Furthermore there would be "flexibility to adjust rules in response to lessons learned about the operation and the efficiency of the auction".²³ A review of the scheme has been promised towards the end of 2015.²⁴ Before then the Commission of Audit may suggest changes. As Malcolm Turnbull put it, "it can be easily terminated. If in fact climate change is proved to be not real, which some people obviously believe - I don't. If you believe climate change is going to be proved to be unreal, then a scheme like that can be brought to an end".²⁵

Another source of uncertainty for business is that the Government's plan only runs to 2020²⁶, notwithstanding Mr Hunt's claim that it is a "20 year system"²⁷ which will provide "a lasting and stable policy framework"²⁸. Bids will refer to emissions reductions over a maximum duration of only five years.²⁹ As Malcolm Turnbull has commented; "because most capital equipment, especially in the energy sector, has a life running into many decades, as long as 50 years in some cases, the business sector is going to require assurance that any government subsidy will match the life of the asset— so running well beyond 2020...If government wants business to make long-term investments to lower emissions, its commitment must be long term as well, which is why a subsidy scheme which terminates in 2020 will achieve very little." ³⁰

Is the scheme adequately funded to achieve claimed emissions reductions?

The Coalition initially said the Emissions Reduction Fund will cost \$2.6 billion over 4 years, and an average of \$1.2 billion per year through to 2020.³¹ If the cost increases roughly linearly over time, this would imply the Fund would be costing around \$2 billion a year by 2020.³² More recently Greg Hunt has said that the scheme would cost \$0.3 billion in the first year, \$0.5 billion in the second year and \$0.8 billion in the third year.³³ Remarkably these are exactly the same amounts as in the 2010

²⁰ *Green Paper*, p 30.

²¹ *Green Paper*, p 36.

²² *The Coalition's Direct Action Plan*, p 15.

²³ *Green Paper*, p 30.

²⁴ *The Coalition's Direct Action Plan*, p 14; *Green Paper*, pp 1, 6, 8 and 20.

²⁵ Malcolm Turnbull, *Lateline*, 18 May 2011.

²⁶ *Green Paper*, pp I and

²⁷ 7.30, ABC TV, 15 July 2013.

²⁸ *Green Paper*, p i.

²⁹ *Green Paper*, p 4.

³⁰ Malcolm Turnbull MHR, *House of Representatives Hansard*, 8 February 2010, p 581.

³¹ *The Coalition's Direct Action Plan*, pp 13 and 30. This was spread as \$0.3 billion in 2011-12, \$0.5 billion in 2012-13, \$0.8 in 2013-14 and \$1 billion in 2014-15. Mr Abbott agreed the cumulative cost would be around \$10.5 billion by 2020; interview with Chris Ullmann, 7.30, 4 July 2011, ABC website.

³² \$2 billion is also Malcolm Turnbull's estimate of the cost in 2020;

<http://www.malcolmturnbull.com.au/blogs/malcolms-blog/the-lateline-interview-response-to-critics/>

³³ Greg Hunt, 'Direct action plan on environment and climate change', speech at ANU, 19 April 2013; *Green Paper*, p i.

document, despite there now being three less years until 2020 within which to start reducing emissions.

There is no explanation of who prepared the initial costing or the basis of the calculation. It implies a cost in 2020 of at most \$14 per tonne (\$2 billion/140 million tonnes) to cut emissions (assuming all the cost goes to payments, although as noted below the administrative costs will be large).³⁴ This seems optimistic; the Labor Government's scheme started with a carbon price of \$23 a tonne and Mr Hunt is not claiming that it is massively overachieving on emissions reduction.

Mr Hunt has been emphatic about the costings, referring to them as "fixed, capped costs...we will not spend a dollar more".³⁵ This seemed an extraordinary degree of confidence about the outcome of an auction to be held months or years away. During the latter stages of the 2013 election campaign Mr Abbott was clearer, saying that if the available funds proved insufficient to buy emissions reductions of 5 per cent, then the promise on emissions would just be abandoned rather than additional funding being provided.

If, as Mr Hunt used to imply, the \$1.6 billion over three years is a fair estimate of the likely cost of the successful bids, this means there is a 50 per cent chance that the cost of achieving the emissions goal would exceed this, and therefore Mr Abbott and Mr Hunt are effectively saying there is at least a 50 per cent chance that the Coalition will break their promise on emissions reduction.

There are a large number of studies which find that the \$1.6 billion will not be sufficient to achieve the 5 per cent emissions reduction aspiration. When the Department of Climate Change assessed the scheme, it found "the costs claimed by the Opposition very difficult to support on the basis of relevant experience".³⁶ If expenditure on the scheme were capped at the Coalition's \$1.2 billion a year average up to 2020, the Department of Climate Change estimated, based on 'multiple estimation methodologies' that emissions in 2020 would be 13 per cent above 2000 levels rather than 5 per cent below.³⁷ A more recent costing of direct action by government departments, assuming all emissions reductions were achieved domestically, suggests that its costs over the forward estimates period would be around \$13 billion more than the Coalition asserts. Even that costing is regarded as "a lower bound, as it is extremely unlikely that a grant tendering scheme would yield lowest cost abatement".³⁸

Another study suggested that, given its cap on the emissions reduction fund, the Coalition scheme would fall 81 million tonnes short of its emissions reduction target.³⁹ Even the Institute of Public Affairs was sceptical about the Coalition's scheme; saying "it would be very difficult for it to achieve its goals".⁴⁰

³⁴ If, as the plan suggests, 85 million tonnes of abatement are achieved at a price of \$10 through soil carbon, then the remainder will cost \$21 per tonne. Greg Hunt has publicly referred to a cost of \$15 per tonne; ABC 24, 18 May 2011, cited in <http://www.climatechange.gov.au/minister/greg-combet/2011/media-releases/May/mr20110518.aspx>.

³⁵ Greg Hunt, interview with Kieren Gilbert, *Sky News*, 12 February 2013.

³⁶ Department of Climate Change, 'Summary of the abatement potential, cost and emissions in 2020 of the Opposition climate change policy', 3 February 2010; Department of Climate Change, 'Analysis of Coalition Climate Change Policy Proposal', p 5.

³⁷ Department of Climate Change, 'Analysis of Coalition climate change policy proposal', 2010, p 3.

³⁸ Minister Wong, 'Opposition budget 2013', 3 August 2013.

³⁹ Tristan Edis, 'Hunt's back of envelope foundations for direct action', *Climate Spectator*, 3 May 2013.

Some optimists about the cost of reducing emissions point to research by McKinsey consultants on the 'cost curve'. It shows that some reductions in emissions, especially through energy-efficiency measures in buildings, are costless and others are low cost.⁴¹ Under an emission trading scheme the market should exploit these opportunities.

But for a tender system such as 'direct action', the problem is that even if some firms could afford to tender at very low prices, they will not do so when they expect that higher prices will still be winning bids. The Department of Climate Change observed that 'in practice in multi-round environmental tenders in Australia and internationally, quickly bids converge to close to the highest bid from previous rounds'.⁴² Treasury has said "there are a number of reasons why sustained price discrimination is unlikely to be practical: the government is often at a substantial information disadvantage compared to the firm bidding for the abatement activity and firms also tend to act strategically which leads to convergence of bids at a higher final price".⁴³ As one commentator put it "It's like when you offer your house for sale. You don't price it based on what you paid for it" but what people are currently paying for similar houses in the surrounding area.⁴⁴

And as the Department of Climate Change have pointed out, "community perceptions of fairness may make it difficult to maintain large differences in the price paid for abatement projects (for example by paying farmers a different price for land management activities than provided to power generators for a change in the fuel mix)".⁴⁵

Experience with similar schemes also suggests the plan is under-funded. A Grattan Institute study examined 300 programmes within Australia since 1997 aimed at reducing emissions and concluded "analysis of a range of grant-tendering programs...shows that they cannot reduce emissions at the necessary scale or speed...Based on experience, government would need to announce an abatement purchasing fund of \$100 billion to meet the 2020 emissions reduction target".⁴⁶

Treasury commented in its 2010 incoming government brief that "the mitigation task to achieve your commitment to reduce national emissions to 5 per cent below 2000 levels by 2020 is significant. It cannot be achieved without a carbon price if damaging economic and budget impacts are to be avoided. Direct action initiatives alone will not do the job."⁴⁷ Treasury has refused to release its 2013 incoming government brief.

⁴⁰ Dr Alan Moran, Institute of Public Affairs, *Joint Select Committee on Clean Energy Future Hansard*, 27 September 2011, p 62.

⁴¹ See for example McKinsey & Co, 'An Australian cost curve for greenhouse gas reduction', 2008; and the calculations by Climateworks, 2011, included in the *Green Paper*, p 13.

⁴² Department of Climate Change, 'Analysis of Coalition Climate Change Policy Proposal', p 21.

⁴³ Department of the Treasury, 'Economic and fiscal impacts of the Coalition's direct action plan', Treasury minute released under Fol, 14 July 2011.

⁴⁴ "Irrespective of whether you paid \$50,000 or \$500,000 for your house, if other people are selling similar homes for \$700,000, that's what you'll ask for"; Tristan Edis, 'Abbott's \$4 billion climate budget blow-out', *Climate Spectator*, 15 August 2013.

⁴⁵ Department of Climate Change, 'Analysis of Coalition climate change policy proposal', 2010, p 11.

⁴⁶ John Daley and Tristan Edis, *Learning the Hard Way: Australia's Policies to Reduce Emissions*, April 2011, Grattan Institute, Melbourne, p 3. A similar estimate is reached by Richard Denniss and Matt Grudnoff, 'The real cost of direct action', *Australia Institute Policy Brief*, no 29, July 2011, p 4.

⁴⁷ Department of the Treasury, http://pandora.nla.gov.au/pan/123021/20101029-1442/www.treasury.gov.au/documents/1875/PDF/Red_Book_Part_1_Redacted.pdf p 10.

An analysis released by the Carbon Institute shows a somewhat simplified form of 'direct action', a more efficient, purer auction process, fails to achieve emissions reductions if the cost is limited to the caps; and an additional \$4 billion would be needed to achieve the 5 per cent emissions reduction by 2020.⁴⁸ The analysis, however, is based on unreasonably favourable assumptions. In particular it assumes that the companies submit bids reflecting their costs of abatement rather than a market clearing price. As discussed above, this is highly implausible.⁴⁹

A possible loophole is that the cap on the emissions reduction fund only runs for three years whereas tenders can run for five. So bids that reduce emissions in 2019 may be successful when bids for emissions reductions in earlier years are rejected because of the cap. This could allow emissions to drop sharply in 2019 and 2020 but only at the cost of creating an enormous budget black hole just outside the forward estimates.

The cost of achieving reduced emissions equivalent to cutting Australia's domestic emissions by 5 per cent could be lowered substantially if some of the abatement was purchased abroad.⁵⁰ But the Coalition are opposed to any purchase of emissions reductions from other countries; "we don't believe Australians should have to pay a great big new tax to fund outcomes in other countries".⁵¹ This does not appear to be based on a legitimate concern to ensure that any purchases overseas are from sound schemes that deliver genuine emissions reductions or a desire to demonstrate that Australia can achieve significant emissions reductions. It appears to be an odd view that only emissions reductions in Australia will reduce the impact of climate change in Australia. Ruling out any contribution from international action means that the reductions in the prices of permits in the EU scheme are of no assistance in reducing the cost of the Coalition's approach.⁵²

Assessing the bids

The Coalition originally intended to "establish an expert body to assess tenders and make recommendations on activities to be supported by the Emissions Reduction Fund".⁵³ It was not clear whether the decisions on successful tenders would be taken by a second bureaucratic body, or by a minister, and the extent to which they would be obliged to take heed of the expert body. Now it seems the decisions will be taken solely by the existing Clean Energy Regulator.⁵⁴ There is no mention of whether unsuccessful tenderers will have any access to an appeals mechanism for review. As the tendered bids will be commercial in confidence⁵⁵, the governance aspects will be particularly important to avoid accusations of favouritism.

⁴⁸ Climate Institute, 'Coalition climate policy and the national climate interest', August 2013; Sinclair Knight Merz. 'A review of subsidy and carbon price approaches to emission reduction', 14 August 2013.

⁴⁹ Tristan Edis, 'Abbott's \$4 billion climate budget blow-out', *Climate Spectator*, 15 August 2013.

⁵⁰ McKinsey point this out; 'An Australian cost curve for greenhouse gas reduction', 2008, p 18. The Business Council called for "no restriction on the number and type of international permits that can be used"; Lenore Taylor, 'Abbott plan would double carbon cost', *Sydney Morning Herald*, 15 September 2011.

⁵¹ *The Coalition's Direct Action Plan*, pp 2, 14. Tony Abbott said at a press conference on 15 August 2013 that "if you simply buy international offsets, there is a sense in which you are shirking your environmental duty".

⁵² Given this, it was a strange comment by Mr Hunt when he said the tender price "will be directed by the market and it is likely to be very strongly informed by events overseas"; Interview with Latika Burke, *ABC 24*, 17 July 2013.

⁵³ *The Coalition's Direct Action Plan*, p 15.

⁵⁴ *Green Paper*, p 29.

⁵⁵ *Green Paper*, p 34.

The assessment process will be much more complex than for a bond tender or even a construction project tender as the bids will cover differing time periods and have to be assessed for “the commercial readiness of the technology...and the credibility of their emissions reduction estimates”.⁵⁶ It would be vastly more complicated still if the 2010 version of direct action is still under consideration whereby “to ensure the Fund supports a broad range of direct action initiatives, measures considered by the Fund will be assessed against similar proposals from similar sectors. Assessment of projects will also take into account any additional significant public policy benefits.”⁵⁷

Minister Hunt has said that payments would only be made after “measurable and verifiable” emissions reductions have been delivered.⁵⁸ This means that the scheme no longer helps firms meet the cash flow requirements of taking action to reduce emissions, notwithstanding Mr Hunt’s earlier claims that “many industries face substantial capital expenditure costs in reducing their CO₂ emissions” and that under his scheme “the capital will be available for business to conduct emission reduction activities”.⁵⁹ In the *Green Paper* the approach adopted is that “the Government will enter into forward contracts with successful bidders”⁶⁰ but this will only assure lenders if they are certain the project will succeed in reducing emissions to the extent promised in the bid. A successful tenderer who cannot line up finance for their project will be defaulting on their forward contract.

Furthermore, if payments are only to be made after emissions reductions are verified, it is surprising that the costing in the plan has payments being made during its first year.

The Coalition’s original plan was silent on whether there would be any fines for successful bidders who do not meet their promised emissions reductions. If there are to be significant fines this will discourage firms with any doubts about their projects from tendering and so raise the cost of the scheme. If there are no fines, many – perhaps most – of the successful tenders will be from firms with speculative bids based on wishful thinking about the subsequent emissions reductions, and so the scheme will fail to realise the stated goal of a 5 per cent reduction. By the time it is realised that emissions reductions are not occurring, it will be too late to accept other bids.

This issue is only partly clarified in the *Green Paper*. The reference to contracts mentioned above suggests there will be consequences for non-delivery but the wording is very vague; “the Clean Energy Regulator could seek redress if emissions reductions are found not to have occurred...contracts will include provisions to encourage the delivery of contracted emissions reductions”.⁶¹ This raises questions about what criteria the Regulator will use in deciding whether to seek redress and whether it will involve more than refunding the payment received.

Assessing the tenders to ensure that they do involve genuine reductions in emissions will not be an easy task. As Malcolm Turnbull has said, “if a scheme operates whereby the government pays the

⁵⁶ *Green Paper*, pp 29-30. This raises the question of whether, for example, a bid of \$16 a tonne using an existing proven technology would be preferred over a bid of \$14 a tonne for a project using a new untested technology.

⁵⁷ *The Coalition's Direct Action Plan*, p 15.

⁵⁸ Reported in Tristan Edis, ‘Hunt puts some flesh on bones of Direct Action’, *Climate Spectator*, 28 February 2013. Mr Hunt claimed “we will only pay for real abatement after it is delivered”; speech to Grattan Institute, 16 July 2013, p 12.

⁵⁹ Greg Hunt, ‘Address to the 5th annual Carbon Farming Conference, 24 October 2012.

⁶⁰ *Green Paper*, p 4.

⁶¹ *Green Paper*, pp 4 and 32.

firm to reduce its emissions intensity...there is firstly going to be a substantial and contentious debate about what the correct baseline is, and then whether it will actually be reduced...Arguments of considerable ferocity will arise as to whether a new piece of equipment would have been bought anyway, with the risk that the government ends up funnelling billions of dollars to companies to subsidise their profit without achieving any real additional cuts in emissions."⁶²

Mr Abbott has made comments that suggest the Government may be walking away from requiring firms to demonstrate that emissions reductions would not have occurred without a winning bid. He commented "there are some businesses that are taking advantage of the carbon tax and there is nothing wrong with that...businesses that are contributing to reducing emissions can certainly apply to the Emissions Reduction Fund to benefit from that".⁶³ The language employed in the *Green Paper* is also weaker, referring only to "reductions that are unlikely to have occurred in the ordinary course of business". The more firms are paid for emissions reductions they are currently undertaking anyway, the less likely is the 5 per cent reduction target to be met.⁶⁴

A study of the experience of governments in assessing tenders for emissions reductions is instructive: "the tender process itself usually takes several years to select the projects and finalise funding agreements. Government tends to struggle to identify the best projects. The assessments required are inherently difficult because the projects often involve cutting edge technology or are highly complex. The process favours overoptimistic bids, which then makes completion unlikely. Furthermore over the long periods involved in rolling out grant tendering programs, unforeseen changes unfold that result in winning bidders' projects becoming uncommercial. At best these programs are a wasteful distraction, since most of the money is never spent".⁶⁵

A similar conclusion was reached by the Australian National Audit Office. Its evaluation of GGAP, a competitive grants programme similar to the direct action programme, "noted shortcomings in the assessment of projects for the first two rounds of the GGAP. The third round also had significant shortcomings in the assessment process...None of the shortlisted project proposals recommended by the department could provide the large scale abatement at low cost, and with a high degree of certainty required by the program's guidelines. The three highest ranked (and recommended) projects were technically ineligible as they did not meet the Australian Government's primary criteria for the program. For these three projects, which were subsequently approved by the then Minister, only one project has produced any abatement to date. However, this was less than one third of the threshold specified for the program."⁶⁶

Another expert commented 'The history of past abatement project support programs is that delivering significant abatement projects takes time and is subject to uncertainty. Blind bidding processes, at least in early rounds, tend to encourage low ball optimistic bids from proponents who later encounter problems implementing projects on time and budget'.⁶⁷

⁶² Malcolm Turnbull MHR, *House of Representatives Hansard*, 8 February 2010, p 581.

⁶³ Simon Cullen, 'Hockey backtracks on carbon tax compensation', *ABC News*, 26 February 2013.

⁶⁴ *Green Paper*, p 22.

⁶⁵ John Daley and Tristan Edis, *Learning the Hard Way*, Grattan institute, April 2011. p 21.

⁶⁶ Australian National Audit Office, *Administration of Climate Change Programs*, Audit Report No.26 2009–10, p 21.

⁶⁷ Tristan Edis, 'Abbott's \$4 billion climate budget blow-out', *Climate Spectator*, 15 August 2013.

The Howard Government's Green Gas Abatement Program, also similar to the 'direct action' scheme, achieved less than half of the abatement planned due to low take-up by business.⁶⁸

The experience of firms tendering is also informative: "Many bidders interviewed by the Grattan Institute indicated that the lack of clarity around how criteria might be interpreted made it very difficult to develop bids and make informed judgements about future investment decisions."⁶⁹

Additional criteria for bids?

Minister Hunt characterises direct action as "a reverse auction to buy back the lowest-cost abatement. This is, for example, the same approach used for buying back water".⁷⁰ This is very different to how the Coalition described it in its written policy statement of 2010, which is surprising given that the minister prides himself that "we haven't changed our system since day one. So, over three years we've been completely consistent".⁷¹

In the earlier version of the plan, rather than a simple auction, further costly complications were introduced by some ill-defined additional criteria. Tenderers would have to show that projects:

1. Reduce CO₂ emissions;
2. Deliver additional practical environmental benefits;
3. Not result in price increases to consumers;
4. Protect Australian jobs; and
5. Not otherwise proceed without Fund assistance.⁷²

Of course, any criteria that disqualify otherwise winning bids further erode the amount of emissions reductions that the capped funding of the scheme could purchase. Assessing compliance with these additional criteria would also greatly complicate the task of assessing bids, especially given the vagueness of the criteria⁷³ and the lack of any weighting to be accorded to the different criteria. Not only would the environmental impacts need to be assessed, but so would the economic impacts and after the winning bids had been chosen, they would need to be checked not just for emissions reductions but also for their economic and other impacts.

This approach now appears to have been abandoned. The Government now says "establishing multiple objectives for the design of the Emissions Reduction Fund could raise costs, as Australia

⁶⁸ Department of Climate Change, 'Analysis of Coalition climate change policy proposal', 2010, pp 7-8.

⁶⁹ John Daley and Tristan Edis, *Learning the Hard Way*, Grattan institute, April 2011, p 26.

⁷⁰ *Green Paper*, p i.

⁷¹ *Lateline*, 18 April 2013. He made similar remarks in his speech to the Sydney Institute, 30 May 2013 and an interview with Latika Burke on *ABC 24* on 17 July 2013.

⁷² *The Coalition's Direct Action Plan*, p 13.

⁷³ For example, does the term 'protect Australian jobs' mean only that the firm making the tender will not sack any existing worker, but will allow attrition? Or does it mean that their total number of employees will remain constant? Or does it mean that the total number of employees will increase by the same amount as if the project was not undertaken? Does it also mean that if the project is successful no jobs will be lost at other companies either? A project that allows a firm to reduce its use of electricity (or change to a less emissions-intensive energy source) could result in a loss of jobs at a coal-fired electricity generator, for example. Would such a project be eligible?

would have to forego lower-cost emissions reductions in order to allocate funds to deliver funds to deliver other benefits".⁷⁴

Other apparently abandoned aspects of the scheme

The *Green Paper* makes no reference to some other elements which the Coalition has previously said would be part of the scheme. For example the version taken to the 2010 and 2013 elections included a vague and uncosted reference to "work with the electricity sector on the design of potential assistance that could be provided through the Fund to ensure both fairness and cost parity for consumers".⁷⁵

There is also no reference to compensation. Asked in Tasmania about what the Coalition would do about businesses such as Hydro Tasmania that would lose from abolition of the current carbon price, Mr Hockey said that compensation would be considered "on a case by case basis" and claimed "we have allocated funds under our Direct Action plan to deal with initiatives that are underway".⁷⁶ Having returned from Tasmania, Mr Hockey put out a statement saying "the Coalition will not be paying compensation for repeal of the carbon tax" before muddying the waters again by saying they "could potentially look at companies that are part-way through changes".⁷⁷

Administrative costs

The Australia Institute has drawn attention to the bureaucratic workload involved in assessing the tenders. Their calculation is that "If we make the generous assumption that the average abatement per project under the Coalition's scheme is 25,000 tonnes of emissions then there would need to be about 28,500 successful projects. If we assume four unsuccessful projects for every successful one then the number of projects assessed would be close to 150,000".⁷⁸ There may be a minimum size bid but its size has not been determined.⁷⁹ The head of the Department of Climate Change said the Coalition's approach would "clearly be more resources intensive" to operate.⁸⁰ His department described it as having "high administrative overheads for government and business".⁸¹ The Department commented specifically that "soil carbon purchasing would inherently involve higher administrative overheads than other abatement due to the multiplicity of small scale grants".⁸²

And because it is an auction, nothing can happen until every tender has been assessed.

⁷⁴ *Green Paper*, p 18.

⁷⁵ *The Coalition's Direct Action Plan*, p 17.

⁷⁶ *Sydney Morning Herald*, 25 February 2013.

⁷⁷ Cited in Lenore Taylor, 'Big firms may get carbon cash', *The Age*, 26 February 2013.

⁷⁸ Richard Denniss and Matt Grudnoff, 'The real cost of direct action', *Australia institute Policy Brief*, no 29, July 2011, page 5. This may be conservative as the NSW Government's Greenhouse Gas Abatement Programme had about nine unsuccessful applications for every successful one.

⁷⁹ *Green Paper*, p 30.

⁸⁰ Mr Blair Comley, Secretary, Department of Climate Change and Energy Efficiency, Senate Environment and Communications Legislation Committee, *Supplementary Estimates Hansard*, 17 October 2011, p 12.

⁸¹ Department of Climate Change, 'Analysis of Coalition climate change policy proposal', 2010, p 3.

⁸² Department of Climate Change, 'Analysis of Coalition climate change policy proposal', 2010, p 3.

The *Green Paper* acknowledges the problem of assessing small-scale actions and proposes 'project aggregation'.⁸³ But it does not explain how this will be done, seeking views on how to achieve it. One possibility mentioned is that "an electricity retailer may work to aggregate emissions reductions achieved through energy efficiency by its customers be they households or small businesses". But while a retailer will know if its customers have reduced electricity use it will not know whether this is due to greater efficiency and whether the reduction would have occurred without the direct action plan. A general problem with aggregation is that if some very good projects are aggregated with poorer ones it could lead to very good projects not being successful tenderers.

Once the successful tenders are selected, for the expenditure to be effective it will be necessary to check that the promised emissions reductions are actually being implemented by the successful bidders, and verify that they would not have occurred without the support. This will require a lot of inspectors empowered to investigate companies' and households' operations in a quite intrusive way, notwithstanding Mr Abbott's rhetoric opposing "a draconian new police force chasing an invisible odourless, weightless, tasteless substance".⁸⁴ Assessing the reductions will be easier for those companies currently reporting under NGERs, but be a harder task for those tenderers who are not registered under NGERs.

Economic impact of the direct action scheme

Despite calling for ever more detailed modelling of the economic impact of the Labor Government's clean energy package, the Coalition has not presented any modelling at all of the economic impact of its own scheme. Treasury argue that "the economic cost of direct action would almost certainly be even larger because it would be less efficient than a market-based carbon price mechanism".⁸⁵

Penalties

The original plan includes a brief confusing reference to a penalty system. In what seemed like a direct contradiction to criticism elsewhere in the document of charging firms⁸⁶, the plan states "businesses that undertake activity with an emissions level above their 'business as usual' levels will incur a financial penalty. The value of penalties will be on a sliding scale at levels commensurate with the size of the business and the extent to which they exceed their 'business as usual' levels".⁸⁷ The size of these penalties is not stated, but they "will be set in consultation with industry".⁸⁸ Mr Hunt sometimes walks away from penalties, claiming that "we don't want punishment. We want

⁸³ *Green Paper*, p 3.

⁸⁴ Tony Abbott, cited in *Herald-Sun*, 29 July 2011.

⁸⁵ A Treasury minute of 14 July 2011 released under freedom of information. See also comments by Dr David Gruen, Treasury, Senate Economics Legislation Committee, *Supplementary Estimates Hansard*, 20 October 2011, p 29.

⁸⁶ On the same page it says the plan "will not be imposing liabilities"; *The Coalition's Direct Action Plan*, p 14.

⁸⁷ *The Coalition's Direct Action Plan*, p 14. This is a direct contradiction of Greg Hunt's claim that the Coalition's scheme does not include "punishment for production"; opinion piece in *Australian Financial Review*, 24 October 2011, p 55.

⁸⁸ *The Coalition's Direct Action Plan*, p 14.

incentives.”⁸⁹ He has also said “we are budgeting zero revenue”⁹⁰, an interesting comment given the criticism the Opposition has made of ‘taxes that raise no revenue’ in the context of the mining tax debate.

Mr Abbott has both confirmed this element of the plan: “under our policy there are penalties on people who do increase their emissions intensity”⁹¹ and denied it: “we don’t believe in penalties”.⁹²

The *Green Paper* is not much clearer, saying that “a mechanism will be developed in conjunction with business stakeholders to provide incentives not to exceed historical emissions baselines”.⁹³ It is not clear how these baselines will be assessed. If it is the same as the average emissions over a five-year period, then any company who increases their output could face the penalties. But the *Green Paper* says the scheme is “designed to allow businesses to continue ordinary operations without penalty”.⁹⁴ Rather than defining these terms, the *Green Paper* leaves them to be “developed in conjunction with businesses”.⁹⁵ It says baselines should “take account of...changes in production levels, the mix of outputs produced, plant maintenance and the quality of inputs used”⁹⁶ but not how this complex task might be achieved. A cynic might wonder how strong penalties will be if they are developed by the firms that will pay them.⁹⁷

The *Green Paper* muses that one option would be for firms to meet penalties by purchasing emissions reductions credits from firms who cut emissions.⁹⁸ This would be taking the direct action plan in the direction of a ‘baseline-and-credit’ emissions trading scheme.

By the time the ‘direct action’ scheme is introduced, there may be firms who would have cut emissions to reduce their carbon price liability but plan to revert to more emissions-intensive processes once the price on carbon has been removed. Miners could also incur the penalty as they run out of cheaper mine sites and move to those more expensive to exploit, for which emissions per tonne of mineral produced could well be higher.⁹⁹

This aspect of the direct action plan has received almost no attention. Yet it potentially imposes costs on firms, either in the form of the penalties themselves or due to firms paying more for cleaner energy to avoid the penalties. These costs could be passed on as higher prices for consumers (but without any compensatory tax cuts or payments). Given its vagueness it creates uncertainty for

⁸⁹ *Lateline*, 18 April 2013.

⁹⁰ Interview with Latika Burke, *ABC 24*, 17 July 2013. Similarly on *Lateline*, 18 April 2013, Mr Hunt said “we are not expecting to raise any revenue”. The *Green Paper* (pp 5 and 38) says “no revenue is sought nor will any be budgeted by the Government...the Government has a clear objective not to raise revenue from these elements”.

⁹¹ Tony Abbott MP, Joint Press Conference, 10 July 2011, Tony Abbott's web site.

⁹² Simon Cullen, ‘Hockey backtracks on carbon tax compensation’, *ABC News*, 26 February 2013.

⁹³ *Green Paper*, p 35.

⁹⁴ *Green Paper*, p 4.

⁹⁵ *Green Paper*, p 5.

⁹⁶ *Green Paper*, p 37.

⁹⁷ Such a cynic might note the experience of developing the Minerals Resources Rent Tax in negotiation with the mining industry.

⁹⁸ *Green Paper*, p 38.

⁹⁹ The Australian Bureau of Statistics recently noted that the emissions intensity of the mining industry has been increasing over recent years, which it attributed to “

business. It also seems to discriminate against existing companies as "provision will be made to ensure penalties will not apply to new entrants".¹⁰⁰

And the implication is that the government will need to calculate a 'business as usual' projection of emissions for every business (not just those currently producing reports under NGERs, or those submitting tenders) against which their actual emissions can be assessed. This sounds like a vast and subjective bureaucratic enterprise to be done by the very economists and officials of whose expertise Mr Abbott is so dismissive. Alternatively, the penalties could be only applied to companies which have been reporting under NGERs¹⁰¹ but this would be quite discriminatory.

Soil carbon

Even before a single tender has been submitted, the Coalition has picked a winner. Their plan states that "the single largest opportunity for CO₂ emissions reduction in Australia is through bio-sequestration in general, and in particular, the replenishment of our soil carbons. It is the lowest cost CO₂ emissions reduction available in Australia on a large scale."¹⁰² Accordingly, the Fund "will support up to 85 million tonnes per annum of CO₂ abatement through soil carbons by 2020—and reserve the right to increase this".¹⁰³ Leaving aside the question of what the 85 million actually means when it is qualified by both an 'up to' and a possible increase beyond; picking soil carbon as a winner goes against the supposed benefit of an auction allowing the market to indicate the least cost option.

The Coalition claims that abatement by soil carbon will cost \$10 per tonne.¹⁰⁴ No source is given, and it is odd that an estimate can be prepared before any tenders have been received. A farmers' organisation has indicated that even at \$23 per tonne abatement through soil carbon is uneconomical.¹⁰⁵ Even a proponent of soil carbon cited by the Coalition when launching the plan said in March 2011 that the price should "start at \$25 and head north".¹⁰⁶ A recent academic study put the cost at \$80 per tonne.¹⁰⁷ The Department of Climate Change doubted that soil carbon abatement could be purchased at less than the cost of other forms of abatement.¹⁰⁸ As noted above,

¹⁰⁰ *The Coalition's Direct Action Plan*, p 14.

¹⁰¹ This is suggested as "the simplest approach" in *Green Paper*, p 36.

¹⁰² *The Coalition's Direct Action Plan*, p 16.

¹⁰³ *The Coalition's Direct Action Plan*, p 16. There is a specific commitment to purchase 10 million tonnes of CO₂ abatement through soil carbon in 2012-13. The 85 million tonnes is over half of the 140 million tonnes reduction needed to achieve the emissions reduction target; *The Coalition's Direct Action Plan*, p 18.

¹⁰⁴ *The Coalition's Direct Action Plan*, p 16.

¹⁰⁵ Mr Daniel Galligan, Chief Executive Officer, Queensland Farmers' Federation, *Senate Select Committee on Scrutiny of New Taxes Hansard*, 25 July 2011, p 17.

¹⁰⁶ Michael Kiely, the co-convenor of the Carbon Coalition, cited by Lenore Taylor, *The Age*, 3 March 2011. She also cites Professor Ross Garnaut as saying it was unlikely that the claimed abatement could be achieved at the Coalition's price and Peter Cosier of the Wentworth Group of Concerned Scientists as reporting that most people in the industry "are sceptical that amount of abatement is achievable at that price".

¹⁰⁷ Marit Kragt et al, 'Assessing costs of soil carbon sequestration by crop-livestock farmers in Western Australia', *Agricultural Systems*, October 2012, p 27.

¹⁰⁸ Mr Blair Comley, Secretary, Department of Climate Change and Energy Efficiency, Senate Environment and Communications Legislation Committee, *Supplementary Estimates Hansard*, 17 October 2011, p 16. He confirmed the department's view had not changed on 21 May 2012.

even were it profitable for farmers to make a bid of \$10, it is doubtful that many farmers would submit bids of around \$10 when all the discussion suggests that bids will succeed at over \$15.

There are also doubts about the efficacy of relying on soil carbon for the majority of the abatement. As Malcolm Turnbull warned: "while it is possible to increase the level of organic carbon in soils by changing the management of the land in question, it is quite another thing to ensure that this increased carbon level is permanently maintained. Soil carbon levels fluctuate with the season, with rainfall and of course depending on the use of the land. There is a great prize here, but before billions of dollars are invested in soil carbon credits there will be considerable work required to agree on appropriate measurement and management methodologies".¹⁰⁹

The CSIRO has cautioned that "there is much uncertainty and debate, particularly within Australia, as to the total potential of agricultural soils to store additional carbon, the rate at which soils can accumulate carbon, the permanence of this sink, and how best to monitor changes in soil organic carbon stocks... Accurate monitoring and verification of soil carbon stock changes, due to the large and heterogeneous background levels are difficult and often prohibitively expensive".¹¹⁰

The Department of Climate Change has warned "Australia's potential to permanently increase soil carbon levels is highly uncertain due to our low rainfall and variable climate. In addition, the permanence of any gains in soil carbon is highly uncertain. It would be difficult, therefore, to rely on abatement from soil carbon to meet national emission targets given our current state of knowledge".¹¹¹ A CSIRO study estimated that the maximum potential abatement through soil carbon was less than 25 million tonnes,¹¹² way below the Coalition's assumed 85 million. Some calculations suggest that even if all wheat, cotton and sugar farming were abandoned in Australia, it would not be enough for soil carbon to generate the emissions reductions the Coalition have suggested.¹¹³

The questions about the permanence of the soil carbon sink raise questions about Greg Hunt's claim that payments will only be made after emissions reductions are verified. How long after CO₂ is geosequestered will the CO₂ emissions be regarded as permanently neutralised?

The Clean Energy Finance Corporation

The direct action plan is about encouraging firms to seek out and deploy more energy efficient technologies. As such it would be complementary to the activities of the CEFC which helps arrange funding for such activities. The CEFC is both able and willing to fund or co-fund projects unattractive to the private sector alone because it has a lower cost of funds, a singular focus, more expertise in assessing these types of project, a longer time horizon and values the 'externalities' that arise from proving new technologies. It would address the financing or "capital allocation" constraint identified in the *Green Paper* as impeding identified energy efficiency projects.¹¹⁴

¹⁰⁹ Malcolm Turnbull MHR, *House of Representatives Hansard*, 8 February 2010, p 582.

¹¹⁰ Jonathan Sanderman, Ryan Farquharson and Jeffrey Baldock, *Soil Carbon Sequestration Potential: A review for Australian agriculture*, CSIRO, 2010, pp iv, 48.

¹¹¹ Department of Climate Change, 'Analysis of Coalition climate change policy proposal', 2010, p 22.

¹¹² Cited by Department of Climate Change, response to question on notice from Senate Scrutiny of New Taxes Committee, 16 September 2011.

¹¹³ Tristan Edis, 'Australia's carbon budget hole', *Climate Spectator*, 2 May 2013.

¹¹⁴ *Green Paper*, pp 14-15.

Meeting Australia's fair share of a global emissions target

The direct action plan only aims at a 5 per cent reduction in Australia's emissions. But, especially as Australia is one of the world's highest per capita emitters, one of the world's wealthiest economies and one of the countries likely to be most adversely affected by global warming, a 5 per cent reduction is inadequate. It does not represent a fair share of the global effort required to restrain global warming to less than 2 degrees.

A draft report by the Climate Change Authority has said that a target of only 5 per cent would "require implausibly rapid acceleration of effort beyond 2020". The Authority believes "a target of 15 per cent by 2020 is the minimum option consistent with what represents an equitable share of the estimated global emissions target to 2050".

Another criticism of the direct action scheme is therefore that it could not be readily scaled up to meet a more responsible and ambitious emissions reduction target. Treasury commented in its 2010 incoming government brief that "many of the direct action measures cannot be scaled up to achieve significant levels of abatement. For those that can be scaled up, the cost per tonne of abatement would rise rapidly, imposing further costs on taxpayers and consumers."¹¹⁵

Public understanding of the economic and ethical issues involved in setting emissions reductions targets is enhanced by the existence of the Climate Change Authority which advises the government on the appropriate targets for emissions reduction. Given that the minister has made and will continue to make public comments on what is an appropriate target it would be very hard for his department to make, and make public, independent assessments which differ. For this reason the proposal to abolish the CCA is a mistake. Similarly the defunding of the Climate Commission was a retrograde act as the Commission made an important contribution to public understanding of the science of climate change at a time when the mass media has misrepresented the science by presenting the propaganda of vested interests as though it were a significant part of the scientific debate.

International aspects of adopting direct action

Replacing a credible emissions trading scheme with a sketchy so-called 'direct action' plan, widely viewed as the approach of climate change delusionists, will have adverse impacts beyond our shores. It will be easily presented as one of the world's largest emitters and wealthiest countries turning away from pricing carbon. It will be misrepresented as indicating that carbon pricing had a serious adverse impact on the Australian economy and so set back the cause of climate action in other countries. Among better informed international audiences it will be seen as an act of selfishness by a rich country unwilling to contribute its share to international action. In Europe it may be seen as Australia reneging on the agreement to link the EU and Australian schemes.

¹¹⁵ Department of the Treasury, http://pandora.nla.gov.au/pan/123021/20101029-1442/www.treasury.gov.au/documents/1875/PDF/Red_Book_Part_1_Redacted.pdf. pp 10 and 11. Treasury secretary Dr Martin Parkinson commented "we did not believe the direct action programme could be scaled", *Senate Select Committee on Scrutiny of New Taxes Hansard*, 24 March 2011, p 26.

Views on the direct action plan

Malcolm Turnbull has said of direct action "I can't cite any economists that agree with it".¹¹⁶ By contrast, Appendix A shows that around 25 Nobel prize winners in economics have expressed support for a carbon tax or emissions trading scheme. Mr Hunt has on a number of occasions suggested that three Nobel Prize winners prefer direct action to a carbon price.¹¹⁷ What they actually said in a short note was that they preferred supporting research into geo-engineering and other technology as a means of addressing climate change to policies that reduce emissions. So they were rejecting 'direct action' as much as a carbon price.¹¹⁸ Indeed they were not asked to look at a 'direct action' model as "it is well known that a uniform carbon tax is the cheapest way to abate emissions".¹¹⁹

In Australia, the Economic Society of Australia polled its members on the statement: "Price-based mechanisms - taxes, subsidies or an emissions trading scheme - as opposed to direct regulation, are the more appropriate mechanisms for cutting greenhouse gas emissions" and 79 per cent of the 531 economists responding agreed with only 11 per cent disagreeing. A subsequent poll was conducted at the Australian Conference of Economists asking whether "the Coalition's Direct Action approach to greenhouse gas emissions is good economic policy". Of the 145 respondents, only 11 per cent agreed and 62 per cent disagreed (of which 43 per cent disagreed strongly). More recently Fairfax Media surveyed 35 academic and business economists; 30 replied that a carbon price was superior to 'direct action', three rejected both, one favoured 'direct action' because it was really 'no action' and the other was a climate sceptic.¹²⁰

A wide range of corporate representatives have indicated that the direct action scheme is inferior to pricing carbon. For example, the Energy Supply Association of Australia remarked: "the industry's preference is for a cap and trade ETS"¹²¹ and "there is a need to rethink the rules with a view to resetting or rethinking Direct Action... we have concerns on specific aspects of Direct Action".¹²² The Institute of Chartered Accountants were asked about the direct action scheme compared to a market based scheme and replied: "we support the most economically efficient way of achieving the reduction in emissions, and based on the evidence that we have seen to date, a market based approach is the most economically efficient way of achieving that reduction."¹²³ The Australian Financial Markets Association opined that "clearly, a market based system is one where you believe

¹¹⁶ Q&A, 28 February 2011.

¹¹⁷ For example, in Greg Hunt, 'No doubt: Coalition government will scrap carbon tax', *The Drum* website, ABC, 11 January 2013; and his speech to the Sydney Institute, 30 May 2013.. The economists are Thomas Schelling, Vernon Smith and Finn Kydland.

¹¹⁸ They were doing so on the basis of some questionable research provided to them, and as part of a project that claimed to rank priorities for spending money, despite a carbon tax raising rather than spending money.

¹¹⁹ From a briefing paper provided to the three economists; R Tol, 'Carbon dioxide mitigation', in B Lomborg (ed) *Smart Solutions to Climate Change*, 2010, p 74.

¹²⁰ 'Tony Abbott's new direct action sceptics', Sydney Morning Herald, 28 October 2013. Dr Chris Caton from BT Financial replied that any economist who preferred direct action 'should hand his degree back'..

¹²¹ Mr Brad Page, Chief Executive Officer, Energy Supply Association of Australia, *Senate Select Committee on Scrutiny of New Taxes Hansard*, 8 June 2011, p 6.

¹²² Mr Matthew Warren, Chief Executive, Energy Supply Association of Australia, quoted by Marcus Priest and Gemma Daley, 'Power companies warn Abbott on carbon', *Australian Financial Review*, 23 April 2013.

¹²³ Ms Geraldine Magarey, Institute of Chartered Accountants, *Senate Select Committee on Scrutiny of New Taxes Hansard*, 17 May 2011, p 17.

that market prices and market price signals generated by an efficient market is the ultimate way to achieve abatement. Direct action is inconsistent with that."¹²⁴ Heather Ridout, then CEO of the Australia Industry Group, has said replacing the carbon price with 'direct action' would create "uncertainty on top of uncertainty".¹²⁵ Their current CEO has commented "a trading scheme with a floating price is preferable to the direct action plan that's currently on the table".¹²⁶

Corporate leaders have also criticised the lack of information about the 'direct action' proposal. Michael Fraser, CEO of AGL Energy recently asked "what actually is the detail of direct action?"¹²⁷ They have also pointed to the damage this can cause; "If we don't know and have confidence about what the longer term settings look like we'll either invest in something that generates poor outcomes more broadly or not at all, and that would be a bad situation."¹²⁸ When the head of the Business Council was asked about direct action he replied "we don't have enough detail. We will have a good look at it when it comes out".¹²⁹ The head of the Australian Industry Group said 'business was confused around what the details of the direct action in 2010 were, it wasn't clear. We're now three years down the track. There is some emerging clarity around it. But it hasn't been finalised'.¹³⁰ This widespread uncertainty about how direct action would operate suggests Mr Hunt is gilding the lily when he claims "we have already held extensive discussions with all sectors to consider how they can engage with Direct Action".¹³¹

A recent poll of 180 companies found that 64 per cent favoured an emissions trading scheme, 29 per cent a carbon tax and only 7 per cent wanting either no action or an alternative approach such as the coalition's scheme.¹³²

Even groups usually close to the Coalition are unsupportive of 'direct action'. The farmers' organisation have said about the Coalition's vague plan: "obviously there is a lot of detail to be worked through in terms of the coalition's direct action plan. We have had some discussions with the coalition on that, but it is fair to say that there is still a long way to go to understand a lot of the detail that is around that proposal."¹³³ The Business Council "believe the most effective system to reduce emissions is one primarily based on a market solution, such as an emissions trading system".¹³⁴

Even the right-wing think tank the Institute of Public Affairs is unimpressed, calling direct action "undesirable" and conceding that "emissions trading schemes are arguably more efficient".¹³⁵

¹²⁴ Dr David Lynch, Australian Financial Markets Association, *Senate Select Committee on Scrutiny of New Taxes Hansard*, 17 May 2011, p 53.

¹²⁵ Ms Heather Ridout, *Business Spectator*, 1 December 2011.

¹²⁶ Innes Willox, CEO, Australian Industry Group, interview by David Speers on Sky News, 2 July 2013.

¹²⁷ Mr Michael Fraser, CEO, AGL Energy, *Australian Financial Review*, 9 May 2013.

¹²⁸ Mr Grant King, CEO, Origin Energy, *Australian Financial Review*, 9 May 2013.

¹²⁹ Geoff Kitney, 'Tony Shepherd ducks out just when he's needed', *Australian Financial Review*, 20 April 2013.

¹³⁰ Innes Willox, CEO, Australian Industry Group, interview by David Speers on Sky News, 2 July 2013.

¹³¹ Address to Grattan Institute, 16 July 2013, p 13.

¹³² 'Business supports ETS: survey', *Climate Spectator*, 1 July 2013.

¹³³ Mr Charles McElhone, National Farmers' Federation, *Senate Select Committee on Scrutiny of New Taxes Hansard*, 17 May 2011, pp 4 and 6.

¹³⁴ <http://www.bca.com.au/Content/101469.aspx>. (accessed 6 March 2013).

¹³⁵ Tim Wilson, Director of Climate Change Policy, institute of Public Affairs, 'Property rights and the ETS', *Climate Spectator*, 19 July 2013.

Professor Garnaut expressed some further disadvantages of the direct action approach: "we would rely on the ideas of a small number of politicians...in sum they would not be as creative or productive as millions of Australian minds responding to the incentives provided by carbon pricing...[but] the really big cost would be the entrenchment of the old political culture that has again asserted itself after the late 20th century period of reform. The big rewards...would go to those who had persuaded the minister or the bureaucrat that their idea was worthy of inclusion in the direct action plan."¹³⁶

How seriously are the Coalition taking direct action?

While the *Green Paper* acknowledges climate science, there is a history within the coalition parties of an ambiguous attitude to the underlying science.¹³⁷ This continues to be reflected in recent appointments of advisers. In May 2011 Greg Hunt announced the formation of a Business Advisory Council¹³⁸, whose members included climate change delusionists such as Dick Warburton¹³⁹ and Hugh Morgan¹⁴⁰ and others with apparently little understanding of the economics of carbon pricing.¹⁴¹ Mr Abbott's own Business Advisory Council is headed by another climate change delusionist, Maurice Newman.¹⁴²

The Coalition did not promote 'direct action' with any enthusiasm at the recent election. They had not updated the written version since the 2010 election. By the 2013 election campaign, it was no longer on the Liberal Party website. There is scant reference to it in Mr Abbott's recently released volume of speeches, *A Strong Australia*.¹⁴³ The Liberals' 'think tank' the Menzies Research Centre, recently released a book, *State of the Nation*, which did not regard climate change as meriting an

¹³⁶ Professor Ross Garnaut, cited in Joint Select Committee on Australia's Clean Energy Future Legislation, *Report*, October 2011, p 5.

¹³⁷ At a public meeting in rural Victoria Mr Abbott described the science as 'absolute crap'; Stuart Rintoul, *The Australian*, 12 December 2009. Interviewed on the ABC's *Four Corners*, Mr Abbott said "Um, I, I have pointed out in the past, ah that ah, there was that high year um, a few years ago, ah, and the warming ah, if you believe the various measuring ah, organisations, ah, hasn't increased". Asked about the IPCC report he said "I certainly think that there is a credible scientific counterpoint"; *Four Corners*, 16 August 2010.

¹³⁸ Greg Hunt, media release, 10 May 2011.

¹³⁹ See, for example, his article in *Quadrant*, March 2011.

¹⁴⁰ Hugh Morgan was president of the climate change denying Lavoisier Group; <http://www.lavoisier.com.au/lavoisier-about.php>.

¹⁴¹ Kate Carnell claimed that the impact of the carbon price on consumer prices would be 3 to 5 per cent; *Meet the Press*, 29 May 2011. The actual increase was 0.7 per cent or less.

¹⁴² Mr Newman has described the science of climate change as "somewhat in tatters" and called subsidies for renewable energy "a crime against the people"; Lenore Taylor, *Guardian Australia*, 16 June 2013.

¹⁴³ Less than two pages in a book of 146 pages, and with no further detail given. According to one count, 'carbon tax is mentioned over 106 times...' "Direct Action" is mentioned just six times'; *Minister for Climate Change media release*, 28 November 2012.

entry among the 15 policy areas covered in essays, the only reference to reducing emissions being denouncing the carbon tax in the essay on resources policy, on the grounds it 'displeased' the coal industry.¹⁴⁴ Similarly, a recent book of essays by Liberal 'intellectuals' called *Future-Proofing Australia* has an essay on protecting the mining industry, but not an essay on climate change.¹⁴⁵ In January 2013 the Coalition released a 50-page document called *Our Plan: Real Solutions for All Australians*, which allocated one paragraph to direct action. Addressing pensioners in 2011, Mr Abbott described the 5 per cent emissions reduction target in the direct action plan as 'crazy'.¹⁴⁶

Funding for the direct action plan is not included in the MYEFO (other than a reference to it in discussion of the contingency reserve).

It is unsurprising that even Coalition members who believe in climate change were not keen on promoting 'direct action' as they know it is an inferior approach. As Greg Hunt said in his thesis:

...the market system is a preferable regime, as it better ensures that the polluter bears full responsibility for the cost of his or her conduct.¹⁴⁷

Before Mr Abbott became leader, Mr Hunt said:

Perhaps our most important domestic policy was the decision of the Howard Government that Australia would implement a national carbon emissions trading system...As the Coalition has long argued, Australia must introduce an emissions trading scheme...¹⁴⁸

...we must pursue a domestic emissions trading scheme...[based on] changes in technology, such as cleaning up the power stations, or changes in behaviour, such as people switching to more energy-efficient lighting and heating...the task is to provide a price signal on electricity, which is more amenable to changed behaviour than petrol...¹⁴⁹

Tony Abbott's mentor John Howard said when announcing his support for an emissions trading scheme:

...the Government will establish an emissions trading regime for Australia based on a cap and trade model. ..One of the first in the Asia-Pacific region, it will be world's best practice... Being among the first movers on carbon trading in this region will bring new opportunities and we intend to grasp them...Stabilising atmospheric concentrations of greenhouse gases will require a deep transformation of the world's energy systems. It will be hard, but it is possible. We do not have to sacrifice economic prosperity.

¹⁴⁴ Don Markwell, Rachel Thompson and Julian Leaser (eds) *State of the Nation: Aspects of Australian Public Policy*, Menzies Research Centre, 2013, p 8.

¹⁴⁵ There is a brief reference in an essay on water.

¹⁴⁶ Philip Coorey, 'Abbott pans his own 'crazy' pollution target', *Sydney Morning Herald*, 19 July 2011.

¹⁴⁷ Greg Hunt & Rufus Black, 'A tax to make the polluter pay', <http://www.scribd.com/doc/50162694/A-Tax-to-Make-the-Polluter-Pay>.

¹⁴⁸ Greg Hunt, 'A new sunrise for solar in Australia', address to Appropriate Technology Retailers Association of Australia Conference, 2 August 2008.

¹⁴⁹ Greg Hunt, *The Australian*, 3 July 2008.

We do need massive investment in low carbon infrastructure and we do need a far-reaching new phase of economic reform here at home to establish a world-class emissions trading system.¹⁵⁰

Emissions trading will ensure that the market rather than governments decide which abatement opportunities should be adopted to reduce emissions at least cost...¹⁵¹

Mr Abbott himself has said (and more importantly written):

There is much to be said for an emissions trading scheme. It was, after all, the mechanism for emission reduction ultimately chosen by the Howard government. It enables an increasing market price to be set for carbon through capping volumes of emissions. The allocation of permits should mean that more carbon-efficient businesses have a surplus that can be sold to more carbon-intensive ones.¹⁵²

We don't want to play games with the planet. So we are taking this issue seriously and we would like to see an ETS...¹⁵³

The Howard Government proposed an emissions trading scheme because this seemed the best way to obtain the highest emission reduction at the lowest cost...as licences would be valuable assets, business would have a strong incentive to compete in becoming environmentally efficient.¹⁵⁴

Mr Hockey has said:

Our very strong view is, we were the initiators of an emissions trading scheme, and we believe in a market-based approach.¹⁵⁵

Mr Abbott has derided emissions trading as “a so-called market in the non-delivery of an invisible substance to no-one”¹⁵⁶. One suspects that had the direct action plan been proposed by someone else he would be deriding it as a so-called tender for the non-verifiable non-production of an invisible substance.

¹⁵⁰ John Howard, 'Address to Melbourne Press Club', 17 July 2007.

¹⁵¹ Australian Government, *Australia's Climate Change Policy*, 2007, p 31.

¹⁵² Tony Abbott, 'A realist's approach to climate change', David Davies oration, 27 July 2009.

¹⁵³ Lateline, ABC TV, 2 October 2009.

¹⁵⁴ Tony Abbott, *Battlelines*, 2009, pp 171-172.

¹⁵⁵ Q&A, ABC TV, 19 February 2009.

¹⁵⁶ Doorstop interview, Camden, 15 July 2013.

APPENDIX A: ECONOMICS NOBEL PRIZE WINNERS ON CARBON PRICING

“Good economic policy forces those who pollute to pay for the damage they do...If climate change is to be slowed appreciably at tolerable cost, it is wise to use the market to provide incentives for individuals and firms to reduce greenhouse gas pollution. In economic terms, the emission of these pollutants meets the classic definition of an externality—the price that individuals and firms face for emitting these pollutants is substantially lower than the social cost imposed by the pollution. Because emissions are not priced, the world is wastefully using up a scarce resource, the earth's ability to safely absorb greenhouse gas emissions. Our selfish inaction pushes increased costs onto future generations, and dangerously increases the probability of extreme events with major impacts on their welfare.”

- Kenneth Arrow (1972 laureate), William Sharpe (1990), Joseph Stiglitz (2001), Eric Maskin (2007), Roger Myerson (2007), Thomas Sargent (2011), Christopher Sims (2011), Alvin Roth (2012), Lars Peter Hansen (2013) letter to President Obama, 14 March 2013.

“The United States and other nations can most efficiently implement their climate policies through market mechanisms, such as carbon taxes or the auction of emissions permits. The revenues generated from such policies can effectively be used to reduce the deficit or to lower existing taxes.”

- Kenneth Arrow (1972), Lawrence Klein (1980), James Tobin (1981), Gerard Debreu (1983), Robert Solow (1987), John Harsanyi (1994) and Paul Krugman (2008).
Economists' statement on climate change, 13 February 1997.

“Global efforts need to...put a sufficiently high price on carbon and deliver the G-20 commitment to phase out fossil fuel subsidies, using these funds to contribute to the several hundred billion US dollars per year needed to scale up investments in renewable energy.”

- Douglass North (1993), James Mirrlees (1996), Amartya Sen (1998) and Elinor Ostrom (2009),
Stockholm memorandum, 18 August 2011.

“We propose a measure that could go a long way toward levelling the playing field: a revenue-neutral tax on carbon, a major pollutant. A carbon tax would encourage producers and consumers to shift toward energy sources that emit less carbon—such as toward gas-fired power plants and away from coal-fired plants—and generate greater demand for electric and flex-fuel cars and lesser demand for conventional gasoline-powered cars...and revenue neutrality means that it will not have fiscal drag on economic growth.”

- Gary Becker (1992), ‘Why we support a revenue neutral carbon tax’, (with George Shultz), *Wall St Journal*, 7 April 2013.

“There is widespread agreement among environmental economists that a market-based program to deal with the threat of climate change — one that limits carbon emissions by putting a price on them — can achieve large results at modest, though not trivial, cost”

- Paul Krugman (2008), ‘Building a green economy’, *New York Times*, 7 April 2010.

“Economic theory gives a simple natural way to fight global warming, which is to have escalating taxes on carbon emissions...People should be taxed to pay a penalty equal to the value of the nuisance that they cause. In this way people who value their emissions more than the nuisance they cause will make those emissions and they will pay the tax. People whose emissions are not valued as much as the nuisance they cause will curb them and will not pay the tax...The economics here is as simple and straightforward as economics ever gets. It would be hard to find any economist who would disagree. It may also be worthwhile noting that this may be one place where economists’ judgments may be different from that of other professionals... we think that over fairly long periods of time that people are fairly responsive to changes in prices.”

- George Akerlof (2001), paper presented to China/US Climate Change Forum, May 2006.

“I’ve been pushing for some kind of a carbon tax for years...Why not put a tax on carbon emissions. It would raise a lot of money, it would reduce the environmental damages in the future, it would solve so many problems”.

- Robert Engle (2003), interviewed on *Big Think*, 2 August 2010.

“A carbon tax set equally for all users worldwide would achieve a given reduction in the use of carbon at the lowest cost... the pricing system induces abatement by those firms that can accomplish it most cheaply.”

- Thomas Schelling (2005), memo on ‘The Greenhouse effect’, and pages 188-189 of his book of collected essays, *Strategies of Commitment*.

“The path to hitting long-run targets...involves many elements including increasing energy efficiency, pricing energy so as to create incentives for efficiency and developing new energy-efficient and low-carbon technologies. To keep the cost of meeting the targeted reductions down, advanced economies should get credit for mitigation that they carry out and pay for in developing countries...with a tradeable credit system, the mitigation is accomplished at least cost.”

- Michael Spence (2001), *The Next Convergence*, 2011, pp 214-218.

“If we restrict emissions and allow people trading rights, yes, those that have the highest use would be willing to pay for that practice by buying credits from those who pollute less. As we reduce the overall amount that can be emitted in this way, that it is a financial incentive that can actually change the production facilities over time.”

- Myron Scholes (1997), interviewed at NPQ roundtable, 31 July 2006.

“The tax is the best—or, if you prefer, least bad—of the ways to mitigate pollution.”

- Milton Friedman (1976), interviewed in 1973.