



Climate Change Alert October 2008

Garnaut Delivers his Final Report on Australian Climate Change Policy – Prepare for a \$35 Carbon Price by 2020

Garnaut reiterates in his Final Report that Australia will be the developed country hardest-hit by unmitigated climate change. Further, he states that urgent global action is required to reduce emissions, regardless of the effects of the current global financial crisis.

The [Garnaut Climate Change Review's Final Report](#) was released on 30 September 2008. It confirms the findings contained in [Garnaut's Draft Report](#) and [Supplementary Draft Report](#), but also provides more comprehensive modelling and policy recommendations for the Government to consider.

The key policy recommendations of the Final Report are as follows:

- > Strong global mitigation is in Australia's interests, and our commitment to cut emissions must be part of a global agreement.
- > The [Carbon Pollution Reduction Scheme](#) will be the key instrument to facilitate reductions in Australia's emissions provided the scheme is designed and implemented well.
- > A strong commitment to climate research and the development of new technologies will be fundamental to Australia successfully transitioning to a low-emissions economy.
- > The burden of mitigation must be distributed equitably internationally and domestically.

Emissions Reduction Targets

- > Garnaut has reiterated his recommendations for emissions reduction targets as detailed in his [Targets and Trajectories Report](#), but he also recommends that Australia push for the most ambitious global target possible.
- > He says Australia should declare its willingness to cut emissions by 25 per cent by 2020, which would be our proportionate contribution to keeping atmospheric carbon levels at 450 parts per million (the 450 scenario).
- > Nonetheless, Garnaut concedes that international agreement on a 550ppm target is more feasible, which equates to an Australian emissions reduction target of 10 per cent by 2020 (the 550 scenario).
- > Despite concluding that the costs of mitigation are manageable, Garnaut acknowledges that achievement of even the softer 550 scenario will require significant changes to our economy compared to a "business as usual" scenario.



- > Under the 550 scenario, Australia's emissions entitlement will be 35 per cent below business as usual levels by 2020 and 90 per cent by 2050, compared with 47 per cent and 94 per cent respectively under the 450 scenario.
- > These drastic diversions from our business as usual emissions levels will require significant investment in low-emissions technology, in particular carbon capture and storage, and Garnaut recommends Australia spend \$2.7 billion annually on such research and development.
- > Garnaut concludes that carbon-intensive Australia will find it more expensive to reduce its emissions than other countries, so in order to meet our reduction target under the 550 scenario, we will need to purchase about \$24 billion of international permits annually.

Emissions Trading Scheme

An emissions trading scheme remains Garnaut's central policy recommendation for climate change mitigation. The key design elements of his proposed ETS (some of which differ from the Government's preferred positions as set out in its CPRS Green Paper) are as follows:

- > Establishment of an independent carbon bank to oversee the scheme.
- > A transition period from 2010 to 2012 with fixed price permits starting at \$20 in 2010 and rising by 4 per cent plus CPI each year.
- > Broad scheme coverage with no permits freely allocated.

- > Emissions-intensive trade-exposed industries to be assisted not with free permits but with cash-equivalent reductions to their permit obligations, with such assistance not exceeding 30 per cent of total permit revenue.
- > The phasing out of the Mandatory Renewable Energy Target (MRET) by 2020 to avoid market distortions.

What Carbon Price by 2020?

As set out above, Garnaut recommends that the permit price should be fixed for the first two years of the scheme (2010 to 2012) with the price of permits starting at \$20 in 2010 and rising by 4 per cent plus CPI each year. This represents the price path economic modelling suggests would be followed in the event of an effective global agreement directed towards stabilisation of GHG concentrations at 550ppm. Looking further afield, Garnaut's modelling suggests that a 550ppm stabilisation target will produce a permit price of about \$35 by 2020.

The justification for fixing the permit price during the period 2010-2012 is that the timing of a global agreement to replace the Kyoto Protocol remains unclear. Without a fixed price, continuing international negotiations throughout the remainder of the Kyoto period are likely to have disproportionate effects on the domestic permit price. After this time, Garnaut proposes that the carbon price should be allowed to float in accordance with supply and demand.

However, the recommendations of the Final Report as to the design of Australia's emissions trading scheme diverge in a number of respects from

the design parameters proposed in the Government's Green Paper. More accurate permit price estimates will emerge after the release of the Government's White Paper in December.

Modelling the Economic Impacts

The Report provides the most comprehensive economic modelling to date on the estimated costs of unmitigated climate change compared with various mitigation scenarios:

Economic Growth

The Report reiterates that the overall cost of mitigation will be manageable under both the 550 and 450 scenarios. Garnaut estimates that Australia's annual economic growth to 2020 will be reduced by only 0.1-0.2 per cent per annum costing Australia a total of 1.1 per cent and 1.6 per cent of annual GDP respectively by 2020.

Inflation

Garnaut concludes that an ETS with a 2010 starting price of \$20 per tonne will cause a once-off increase in the consumer price index (CPI) of approximately 1% and should not trigger continuing extra inflationary pressure as the carbon price rises. This is much less than the inflationary impact of the introduction of the GST in 2000.

The proposed assistance to low-income households would play an important role in maintaining price stability and real purchasing power.



Terms of trade

Australia's terms of trade are likely to be lowered as a result of global mitigation, due to the expected decline in demand for fossil fuels, of which Australia is a net exporter. Most other developed countries are net importers of fossil fuels; therefore their terms of trade will improve with strong mitigation.

Household incomes

The Report shows that an average weekly income of \$702 is expected to rise to \$820 by 2020 under business as usual estimates, compared with \$811 under the 550 scenario or \$808 under the 450 scenario. When put into context, climate change mitigation will cost average Australian households \$290 per annum out of their \$20,000 per annum wealth increase.

[The Climate Institute](#) and [the Greens](#) support the 450ppm target and argue that the additional \$3 per week per household is a small price to pay for the significant additional environmental benefits that the stronger 450ppm target would provide, such as the survival of the Great Barrier Reef.

Electricity Prices

The Report suggests that because our electricity supply is the most emissions intensive of all developed nations, the biggest price impact will be on electricity prices, which will be 37% higher than without mitigation by 2020 under the 450 scenario (about \$8 a week more on the average bill) and 21 per cent higher under the 550 scenario.

Sharing the Mitigation Burden

The Report recognises that certain community sectors will be more heavily hit than others and suggests that maintaining full employment and developing effective social policies will be the key to equitable emissions reductions.

Industries

The sectors which will contribute the most to Australia's mitigation efforts are electricity generators and transport, with economic modelling suggesting that the electricity sector could be mostly decarbonised by 2050 due to the pressure of high carbon prices.

However, Garnaut criticises the Government's proposed exemption of certain sectors from the CPRS, compensation to industries such as the stationary energy sector and its proposed petrol excise offset. Nonetheless Garnaut agrees that structural adjustment assistance will be necessary in the worst-affected regions to assist in the transition to a low-emissions technology economy.

The Report concedes that some form of compensation to trade-exposed emissions-intensive industries will be necessary to address the failure of our trading partners to adopt similar policies and to avoid "carbon leakage".

Low-Income Households

The Report also concludes that low-income households will be among those hardest hit by climate change mitigation. Garnaut proposes a household

adjustment package which would see half of the total permit revenue collected by the Government being paid to households in the bottom half of the income distribution spectrum. The assistance would be provided through the taxation and social security systems as well as a 'green credit' system which would assist households switch to using energy efficient appliances.

The Next Step

Although the Final Report is likely to be strongly influential, the Government is not bound to accept any of Garnaut's recommendations and we have already seen some diverging positions emerge between Garnaut and the Government.

The Government is scheduled to release further Treasury modelling by the end of October whilst the Government's White Paper on the final design of the CPRS, including draft legislation, is due to be released by the end of the year. The Government has also committed to releasing its proposed 2020 emissions reduction target range by the end of the year, which will roughly coincide with the United Nations Climate Change Conference in Poznan in early December.

At Poznan, the international community is expected to agree on a plan of action and programmes of work for the final year of negotiations towards the development of post-Kyoto agreement. If no global agreement is reached at Copenhagen in 2009, Garnaut warns that "the failure of our generation would lead to consequences that would haunt humanity until the end of time".



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