



# Pre-election greenhouse grab is on

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Emissions trading can  
create vast new  
riches. but for whom?

**S**INCE the Prime Minister's late but welcome conversion to a policy of cutting Australia's greenhouse gas emissions without waiting for a global treaty — and using an emissions trading scheme to do so at least cost — debate has rightly focused on emission targets. But neither the Coalition nor Labor will set any near-term target before the election.

So how about trying to pin down either party on the second big question about emissions trading: its fairness? Will either party tell us who will get the tradeable emission permits when they're created?

For while emissions trading minimises the total cost of cutting emissions, it inevitably creates new riches worth far more than total costs. And we're talking big potatoes here. At a permit price of \$25 a tonne of carbon dioxide — quite plausible early in the next decade if

energy and industrial emissions are just capped at current levels, rather than growing at 2 per cent a year as they have been since 1990 — then permits for these emissions would be worth about \$10 billion a year. That's about 1 per cent of GDP, every year.

So it's no surprise that some big business emitters are making an old-fashioned, Wild West grab for these new property rights, by lobbying for free carbon permits in proportion to recent emissions ("grandfathering").

Sometimes this comes with threats, as when Paul Simshauser, the head of Babcock and Brown Power, told a recent APEC energy meeting that Australia's least efficient coal-power generators should be given free permits for their greenhouse gas emissions to prevent them behaving like "a wounded bull" and shutting down capacity to send the price of electricity soaring. But unlike with frontier land or water rights, if government gives in to such pressure, business will make huge windfall profits at the expense of ordinary consumers.

How can this happen? Faced with a carbon cap (and price), emitters pass much of their cost of carbon permits through as higher prices. This is necessary, so the whole economy has an incentive to use less carbon-embodying products, such as electricity, aluminium and steel. But the pass-through means that any profit losses to emitting companies are much smaller than their permit costs. So giving out all the carbon permits for free, and in proportion to recent emissions, gives emitters huge, unjust profits.

This key lesson from carbon economics is not just theory. It's been estimated that to keep



existing profits, electricity generators would have needed only between 20 and 40 per cent of their permits for free under the recently introduced European emissions trading system, because they now charge higher electricity prices. Instead, their greenhouse grab worked, and they got nearly all their permits free. Result? Windfall profits of about 5 billion euros to electricity generators in 2005.

To its credit, the Prime Minister's task group report on emissions trading recommended a much fairer principle than grandfathering: giving free permits only to compensate for disproportionate economic losses from the big market shifts caused by emissions trading. The rest of the permits would be auctioned, with the revenue used initially to promote innovation in low-emissions technology, and greater energy efficiency.

Fairer still would be to auction all the permits — after all, changes in policy are part of normal business risk, and a carbon price has been visible on the horizon for years now.

True fairness might mean using auction revenues also to compensate low-income consumers for higher energy bills, and workers in the most affec-

ted industries for job losses. But given the billion-dollar politics at stake, the task group's proposals are probably the fairest one can hope for.

So where's the problem? First, the Prime Minister has yet to say whether he accepts his task group's principles for permit allocation. Second, he has accepted the task group's leisurely timetable, which includes not setting a near-term target until 2010. That target, along with (contestable) economic modelling, is needed to calculate any "disproportionate losses". Perversely, for some emitters this could mean that raising rather than cutting their emissions until then is the best strategy, in order to get more free permits in 2010.

Finally, Labor has not yet said anything about permit allocation either. Meanwhile, persistent lobbying goes on behind the scenes. The greenhouse grab is on, and the bulls might yet make a run for it.

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