The new price is right - making sense of the Government's carbon proposal

Last week, the Gillard government and the Greens announced their plans to place a fixed price on Carbon by mid next year.

Full details of the proposal are yet to be released. Until these details are known, the full implications for householders, businesses and investors are uncertain.

In the meantime we examine the information that has been made available and consider the overseas experience of a carbon tax.

What does Gillard's proposed carbon tax involve?

- Fixed price on carbon by 1 July 2012;
- Increase in fixed carbon price annually at a pre-determined rate;
- Transition from a fixed-price to flexible price under the cap-and-trade Emissions Trading Scheme ("ETS") by between 2013 and 2015;
- Review of fixed price on carbon at least 12 months prior to the implementation of the ETS to determine whether the ETS should be deferred;
- Emissions under the Carbon Farming Initiative to be excluded;
- No use of international emissions units for compliance under the fixed price on carbon. It is contemplated that internal emissions units would be available to be used under the ETS, provided certain compliance and quantity criteria are met; and
- Assistance mechanisms to be considered for households, communities and businesses.

What is the principle behind a carbon tax?

The idea of a tax on carbon is to ensure that the social costs of carbon emissions are properly reflected in the cost of a good or service which emits carbon. By factoring in these "externalities", goods and services which do not emit a lot of carbon are better able to compete in the marketplace, thereby giving a competitive advantage to "clean" technology.

It is expected that as a result of a carbon tax which factors in these externalities, consumers of energy will change their behavior patterns in three ways:

- Use less carbon-intensive fuels;
- Decrease energy use and / or increase the efficiency of their energy use; and
- Demand products which are less negatively impacted by the carbon tax. [1]

How will the carbon tax be applied?

There are generally two stages where a carbon tax may be applied:

- Upstream: this is an entry-point tax. It would apply to the fuels which will emit carbon at the point at which they enter the Australian economy and would capture imports.
- Midstream / downstream: the tax attaches to the actual emissions as and when they are emitted. This means that more would be subject to the tax than the upstream approach.

From the documentation available the proposed carbon tax will apply midstream / downstream, with significant support to be provided to household, communities and industry.

What price for carbon emissions?

It's all about the price at which the overall cost of reducing carbon emissions will meet the benefits of reducing those emissions.

To give you an idea of what to expect, reports are suggesting that a carbon price of $25 - $35 per ton is expected by industry players. Origin Energy has indicated that a price on carbon will only be effective at $25 per ton or more. [2] A Reputex analysis suggests that at this price, the annual cost of carbon will be approximately $3.3 billion to those companies affected in the ASX200.[3]

Where will all the revenue go?

The Gillard government has stated that the revenue will go to funding the support mechanisms put in place by the government to assist households, communities and industries. The Gillard government has also stated that the funds will be dedicated to "tackle climate change". However, the competition for these resources is likely to be fierce.

What has been the experience of other countries?

Sweden

Sweden has had a carbon tax since 1991 and the effects have largely been positive. [4] The Swedish carbon tax was introduced as part of an overall tax structure which was designed to limit the use of oil. During this period, Sweden reduced greenhouse gas emission by 9% and at the same time experienced growth of approximately 48%.[5] The Swedish carbon tax came in at 27 Euros per ton and has risen rapidly to approximately 150 Euros per ton.

The caveats:

- The carbon tax was implemented in the context of a number of other energy taxes. However these energy taxes were reduced by 50% when a carbon tax was introduced. In fact, when first introduced, industries received an entire exemption from the energy tax and only had a liability of 50% in relation to the carbon tax;
- Industries benefit from a 79% reduction in liability when compared to households; and
- The carbon and Electricity tax is not applied to electricity production but the Swedish government provides investment grants for biomass and wind generation plants. However, non-industrial consumers do pay a separate tax on electricity.

Britain

The UK has had a Climate Change Levy since 2001. However, the levy does not apply to domestic, transport or energy sectors, or to selected energy sources such as renewable electricity.

The UK government offered in the region of an 80% discount to energy intensive businesses on the proviso that the sign up to the Climate Change Agreement and adopt specified binding targets for energy use or carbon emissions. The Climate Change Agreement involves two stages:

1. The specific sector negotiated an umbrella agreement with government to determine a target to apply to that sector specifically; and

2. An entity within that sector applies for a reduced rate certificate which will give rise to a discount on the levy provided certain criteria are met.

The Climate Change Levy was also complimented by the UK Emissions Trading Scheme where entities could buy emissions allowances under the ETS to assist in meeting their targets under the Climate Change Agreement. Any excess savings could be sold into the ETS as well.

A 2009 report into the effectiveness of the Climate Change Levy and Climate Change Agreements in improving energy efficiency (its stated goal), highlights that whilst the Climate Change Levy has been largely successful, the existence of Climate Change Agreements have, when considered in isolation, resulted in positive growth in carbon emissions of at least 5% and in some cases up to 26%. The report concludes that the Climate Change Levy should have been implemented at the full rate for all business, which, incidentally, would have minimal impacts on economic performance.[6]

The result of the levy has seen an increase to business energy bills of approximately 15%.

The caveats:

- Does not apply to domestic, transport or energy sectors, or to selected energy sources such as renewable electricity
- The levy is focused on improving energy efficiency;
- Downstream application: The levy is applied on a per-usage basis, that is, depending on the type of fuel used to produce the kilowatt hour of energy, a certain tax rate per kilowatt hour will apply; and
- Complemented by a UK Emissions Trading Scheme (“ETS”) and other government support mechanisms for the renewable energy industry.

What can we learn from the experience of other countries?

It is clear from the Swedish and British examples that although fundamentally, a carbon tax can be economically viable if set at the right price, the equally pressing concern is how the proposed carbon tax is supported and its effects cushioned by the regulatory environment surrounding it.

The British example of supplementing a “downstream” levy with Climate Change Agreements was conceptually a valid approach. It attempted to link any cushion for businesses using energy into overall emissions reductions targets for the sector to which that business belonged. It must be remembered however that an ETS was very much a part of the regulatory environment surrounding the levy. A carbon tax existing in isolation is very much a different proposition and is what faces Australia in at least the short term.

The Swedish example is an illustration of how a carbon tax can apply without the support of an emissions trading scheme.[7] The burden of that tax would appear to be largely on households as industries were largely insulated through reduced liabilities to pay the taxes on energy and carbon. Although it does not apply to electricity production and was principally aimed at reducing Sweden’s dependence on oil, there is no doubt that it had a marked impact on the make up of energy generation in Sweden with a concerted push towards biofuels in the district heating system. However, it must be noted that at the time of the carbon tax, Sweden already sourced a large amount of its energy from renewable sources and its particular geographic location, industrial structure and regulatory environment provided a solid foundation for this policy approach which would not be amenable to the current structure of the Australian market.

What’s in store for businesses?

Australia already has the *National Greenhouse and Energy Reporting Act 2007* which requires that companies which meet a minimum threshold identified in section 13 of the Act report on emissions, energy consumption and production and other specific information. The Act also provides for greenhouse and energy audits to take place to determine the level of a company’s compliance with the Act.

It is likely that this Act will continue to supplement the proposed carbon tax and future ETS. However, the question of which corporations are captured by the threshold will need to be addressed. If a carbon tax is to apply to all emissions then the question of threshold is removed.

However, if the threshold is removed compliance becomes a much larger issue. When disclosure of emissions is required from *all* entities which emit carbon then the auditing resources will become stretched and determining whether a company is required to be registered as an emitter will be difficult.

The offsetting of carbon and auditing process for such offsetting mechanisms will also pose difficult legal and compliance issues. As mentioned, it is currently contemplated that international emissions units will not be available to be used to offset a liable company's Australian carbon tax obligations in the short term. This reduces the short-term complexity of offsetting but careful auditing of the output of renewable energy will need to be implemented.

Conclusion

Whilst there may be some time to go before we learn of the details of the proposed Carbon tax, the experience of other countries with carbon tax policies suggests that a price on carbon need not mean the death of business. There is experience that it may even be profitable for businesses, provided that the framework is sound.

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[1] Congessional Research Service, Carbon Tax and Greenhouse Gas Control: Options and Consideration for Congress (2009), 2.
[2] Lexi Metherell and Paul Kruger, 'Carbon Tax Plan Raises Long List of Questions', ABC News (Australia), 24 February 2011.
[3] Matt Chambers and Annabel Hepworth, 'Industry Slams Carbon Gillard's Call', The Australian (Australia), 25 February 2011.
[4] Bengt Johansson, Swedish Environmental Protection Agency, Economic Instruments in Practice 1: Carbon Tax in Sweden (2000); Oliver Truc, 'The Carbon Tax Has Proven Its Effectiveness in Sweden', Truth-Out (Sweden) 2 July 2009.
[5] Oliver Truc, 'The Carbon Tax Has Proven Its Effectiveness in Sweden', Truth-Out (Sweden) 2 July 2009.
[6] See Centre for Economic Performance, "CEP Discussion Paper No 917: The Impacts of the Climate Change Levy on Business: Evidence from Microdata" (2009).
[7] The EU emissions trading scheme was only introduced in 2005. Sweden's carbon tax was implemented in 1991.