

Carbon pricing mechanisms

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How to price carbon?

Carbon Tax	Hybrid eg Fixed Price Permit Scheme	Emissions trading
Price set by govt	Price set by govt (at start)	Market price
Quantity response in markets	Quantity response in markets (at start)	Quantity set by govt (includes int'l trading)
Differences in who can trade internationally		
Locked in	Transition to emissions trading readily possible	Locked in
Questions of revenue use and problems of lobbying similar for all options		

Fixed-price permit scheme and transition to ETS

Near-term:

Fixed price permit scheme

Govt issues permits at fixed, rising price; no banking

Some forward auctioning possible

Govt-to-govt international trading for compliance, no private trading

→ Govt bears compliance cost risk for a binding national target

→ Efficiency losses as int'l prices and domestic price differ

Longer-term:

Emissions trading scheme

Govt auctions fixed quantity of permits, in line with national target

Price determined in market

International trading by businesses at international price

→ Compliance cost risk borne by emitters

→ Cost-effective outcome under private trading

International climate commitments and policy

Ideal world	Real world
Policy certainty – least cost mitigation trajectory	Uncertainty – delay and unnecessary cost [2 nd best infrastructure?]
Australia's target and trajectory agreed and binding	Australia's target remains a range, politically unresolved [-5 vs -25-40?]
Binding international agreement on targets (or on common price?)	Targets and pledges for 2020 – ambitious but not binding [reliable?]
Common form and scope of commitments	Countries' pledges based on variety of different premises [comparable?]
Widespread domestic emissions trading	Emissions trading only in some countries [market trading?]

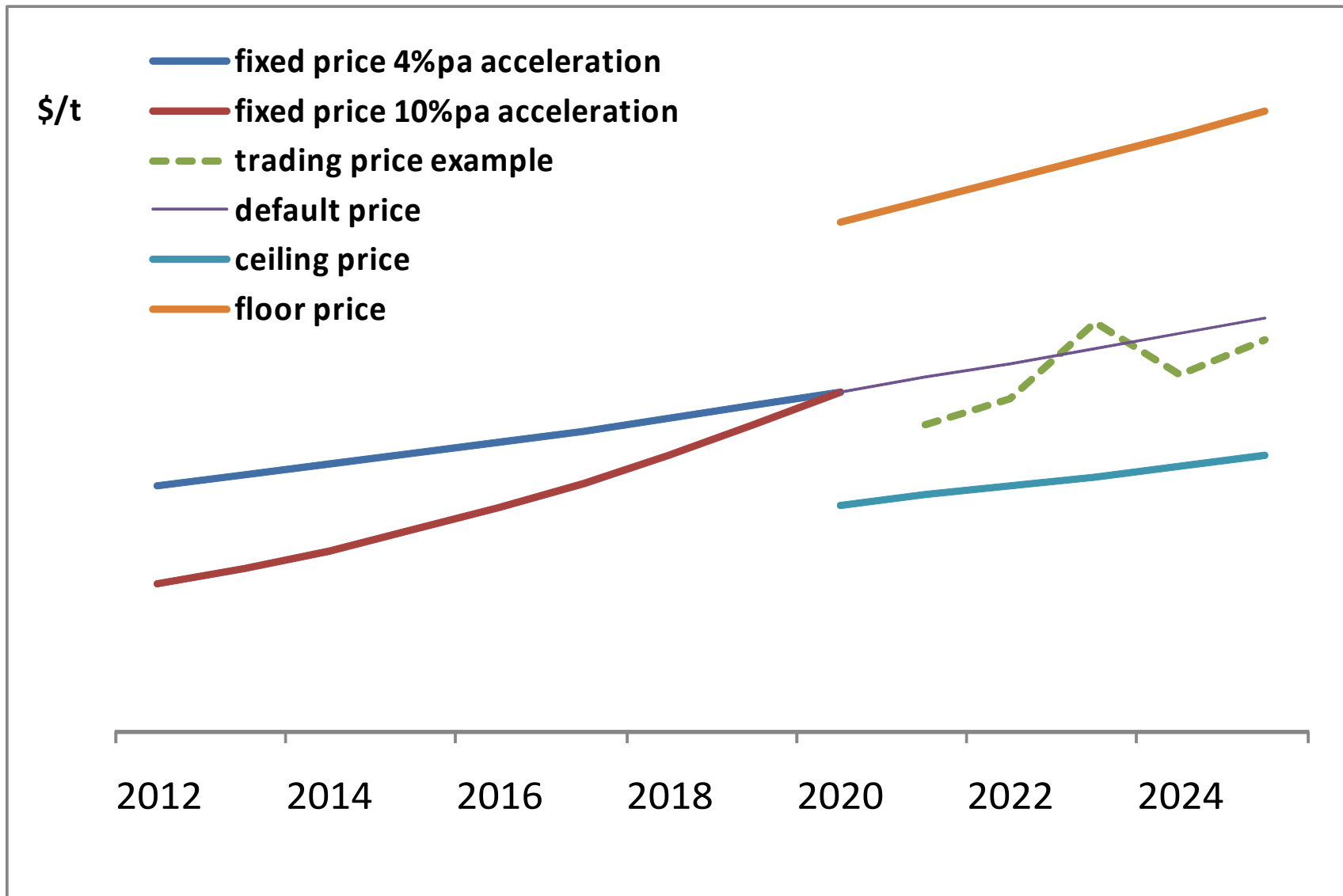
Attractions of a fixed-price permit scheme

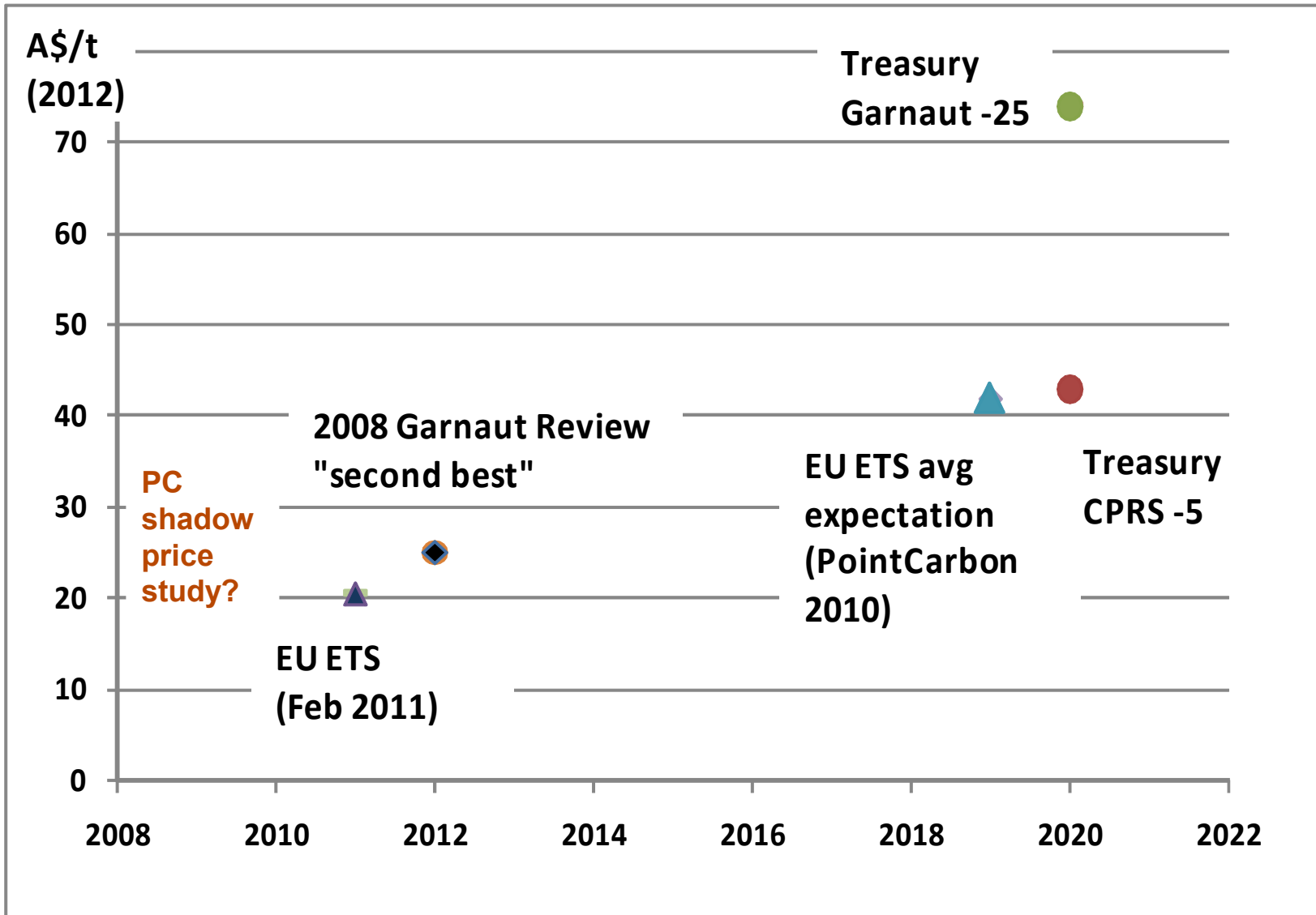
- **No immediate need to resolve Australia's target, nor for deep international markets**
- **Carbon price highly predictable in short term, can start from low base**
- **Can start soon**
 - **Create solid expectation of longer-term carbon price**
 - **Show that carbon price does not stall the economy**
 - **Enhance credibility and avoid costly delay**

When to shift from fixed price to floating price?

- **CPRS: 1 year**
- **Current policy discourse: “short period”**
- **Could it persist?**
 - **Create incentives for emitters to shift to ETS**
- **Conditions for transition:**
 - **National target clarified, in context of int'l action**
 - **International trading opportunities for business**

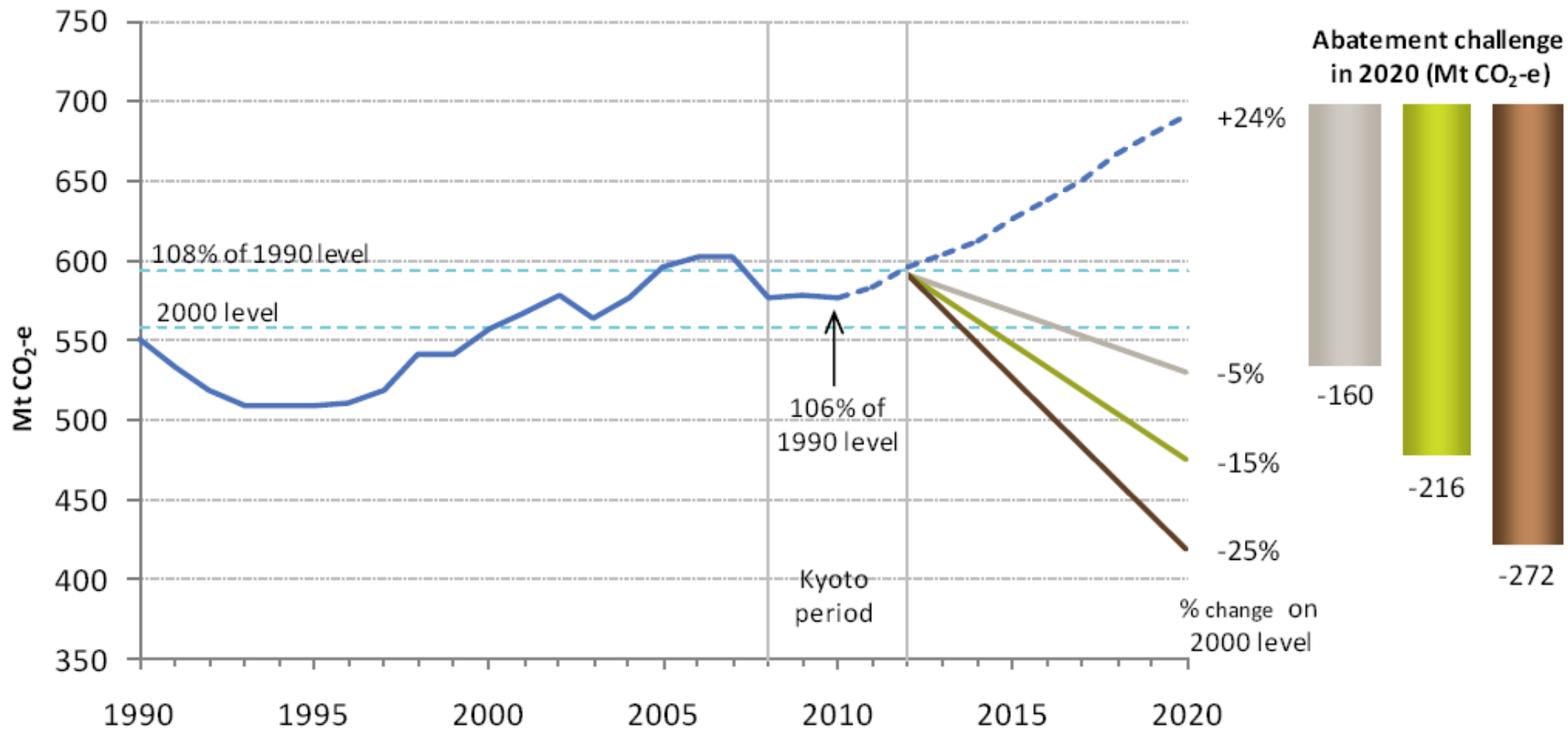
Carbon price trajectories





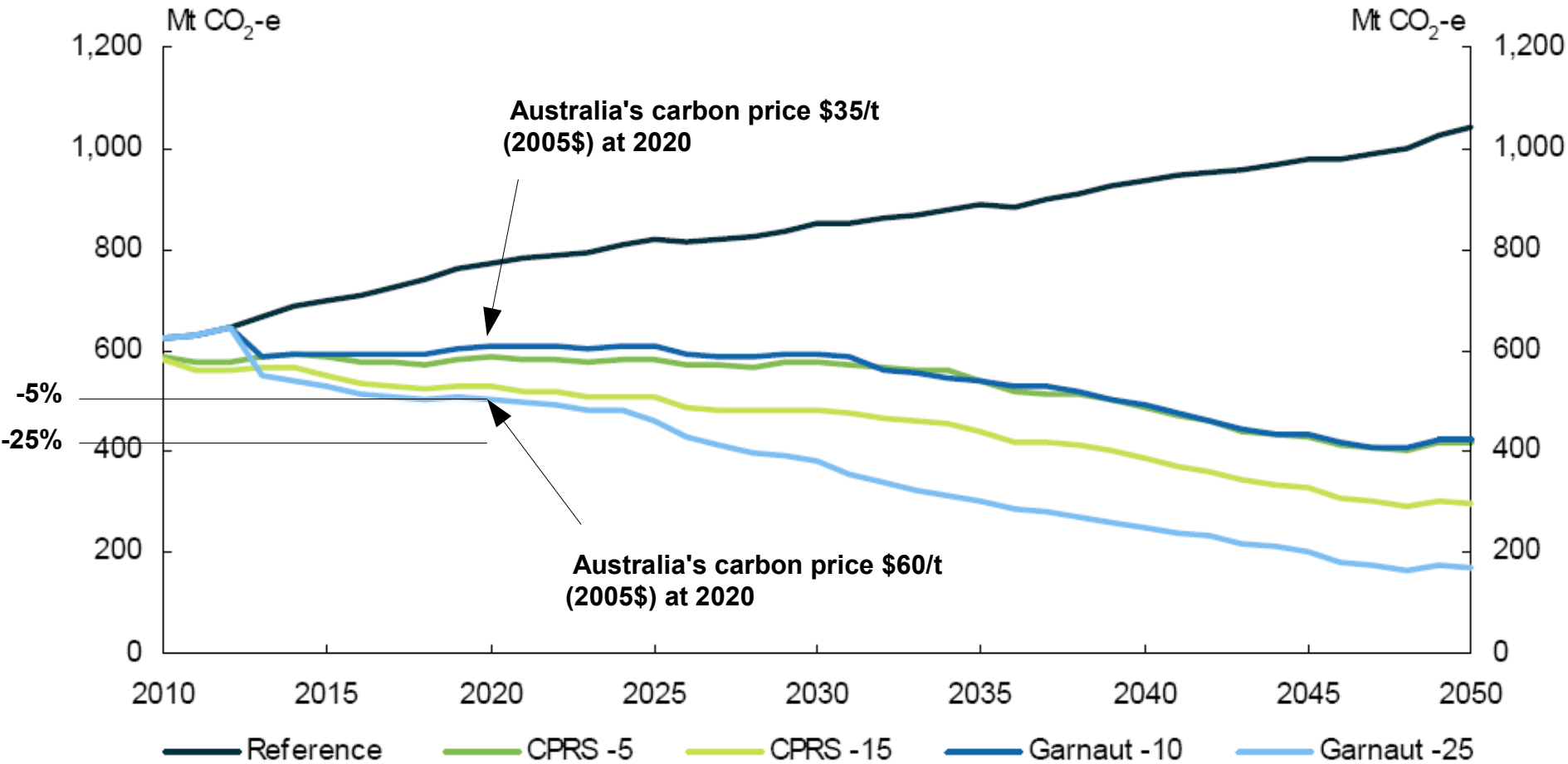
Australia's target range

Figure 1 Australia's emissions trends, 1990 to 2020



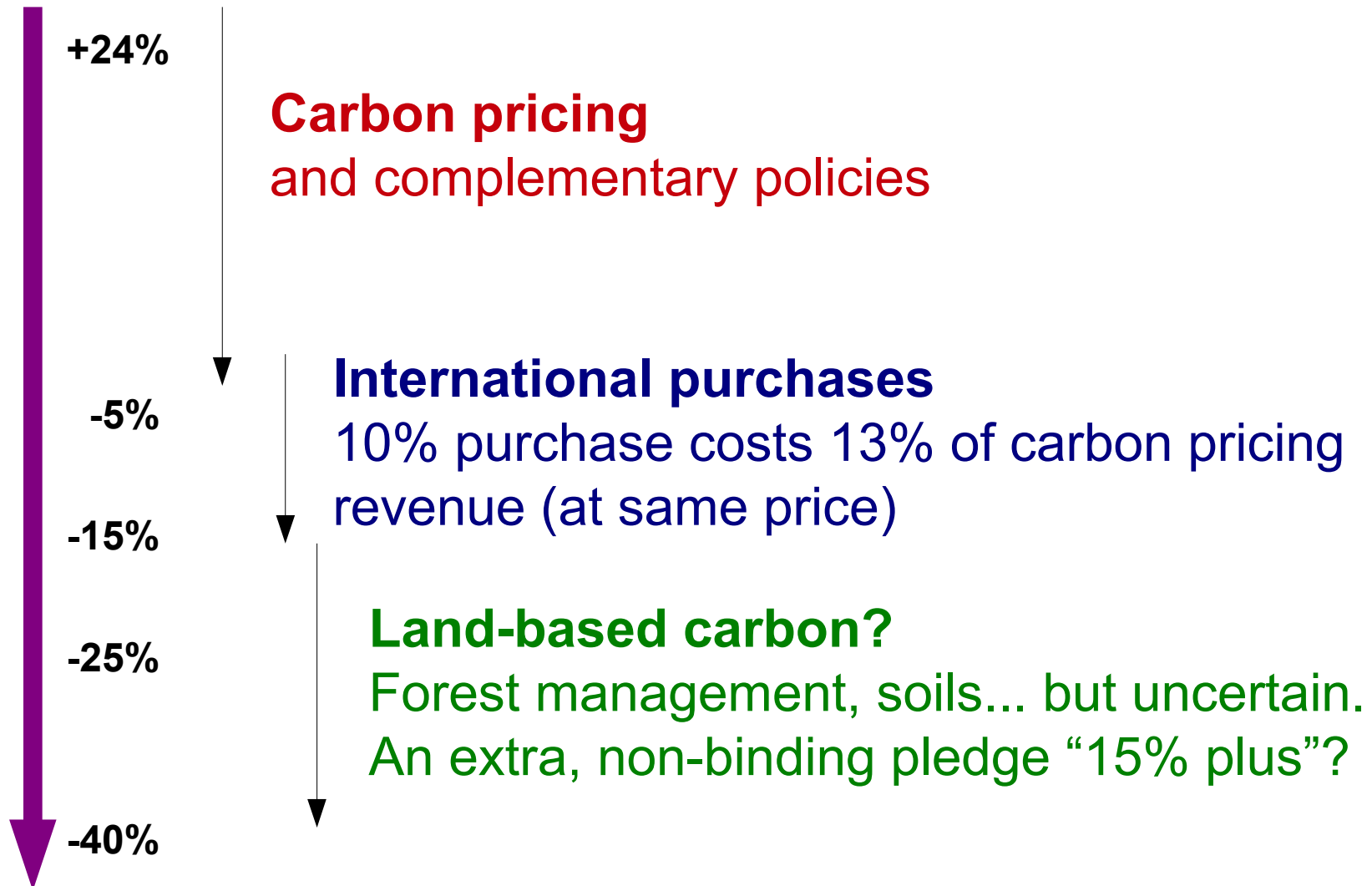
Don't expect deep domestic cuts in short term

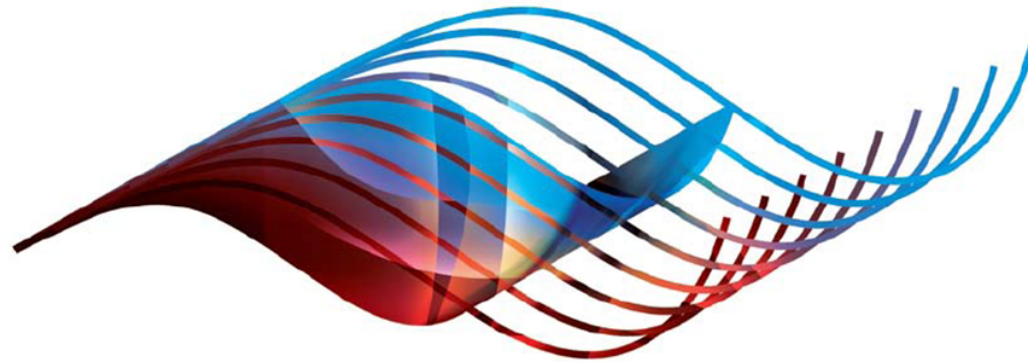
Chart 6.4: Australia's emission pathways



Source: Treasury estimates from MMRF.

Treasury 2008, "Australia's Low Pollution Future"





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