Corporatism Masquerading as Environmentalism

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If the carbon tax was "socialism masquerading as environmentalism", then the Abbott government's Direct Action plan must be corporatism.

It relies on big government using big regulation to pick big corporate winners.

The irony is that it will be introduced just as the last vestiges of the most iconic corporatist policy – car subsidies – are coming to an end.

In the mid-1980s, the Hawke Government implemented corporatist policies to assist the car industry adjust to financial deregulation and tariff reduction. The 'Button car plan' introduced big bureaucratic regulation through the Automotive Industry Authority. The Button plan aimed to use the Industry Authority to create incentives for domestic car manufacturers to increase car production, and rationalise their production by having fewer separate manufacturing facilities.

As is now obvious, the mixture of corporate handouts and command-and-control regulation ultimately failed.

In the long run, despite the best of intentions, government intervention in the economy only serves to distort the efficient allocation of resources. This is something that the Abbott Government appears to understand, as recently it has carried a relatively consistent message on corporate welfare.

But if Direct Action is introduced, it would represent a complete reversal of this welcome hard line against corporate subsidies. Direct Action is a rent-seeker's dream.

Environment Minister Greg Hunt says "the Emissions Reduction Fund is a classic market mechanism".

It is anything but. Direct Action is the antithesis of a classic market mechanism. It is, instead, an attempt to restructure high carbon emitting sectors of the economy using a mixture of corporate welfare and command and control regulation.

The central feature of the Direct Action plan is the Emissions Reduction Fund. The new fund is set to commence on 1 July 2014, and will be armed with initial allocations of $300 million, $500 million and $750 million over the forward estimates. The policy is likely to cost substantially more over time as the 2010 policy document anticipated that the fund would spend an average of $1.2 billion annually through to 2020.

A 'reverse auction' process will be used to identify the lowest-cost emissions reductions. Big businesses with high existing emissions intensity are likely to be favoured due to their economies of scale. Smaller operators will be forced into forming co-operatives in order to place competitive bids for projects. The bidding system will be complicated by minimum and maximum project sizes, budgets for each individual auction, and price ceilings.

Under Direct Action, unlike most 'classic market mechanisms', the government will make up the entire demand side of this 'market'.

The underlying operating assumption is that government handouts are required to fund emissions reduction projects, as the entities would not undertake these projects without government intervention. The Green Paper is explicit: "emissions reduction methods should provide practical and credible ways to calculate emissions reductions that are unlikely to have occurred in the normal course of business".

Given the fund's assumptions, the government has to provide entities with a bottom-line incentive to bid for projects. This is particularly so where the Direct Action plan allows businesses to continue their 'business-as-usual' emissions without penalty.

There will be two ways that an entity will be able to extract value out of the Fund. The first is where an emissions reduction project provides no long-term cost saving to the entity. In this case, the government will need to pay the entity a premium over and above the actual costs of the project – including the costs of compliance. The second is where an emissions reduction project will provide a long-term cost saving to the entity, but the rate of return is too low to justify the capital outlay.

The rent seeking has already begun. In a submission on the design of the Direct Action plan, Qantas said that it had identified several projects that could reduce its emissions. It listed projects like investing in a fleet of fuel-efficient aircraft, which would cut Qantas' fuel consumption costs. Another project was improving air-traffic management, which would cut costs by increasing Qantas' efficiency and productivity.

It is remarkable that a government that was so explicit in not bailing out Qantas directly could potentially be subsidising its new aircraft.

'Classic market mechanisms' usually do not require big regulators. In this case however, the government will rely on the Clean Energy Regulator to administer the Fund. This is the same body of bureaucrats established in 2011 by the former Labor government to administer the carbon tax. The regulator currently has a broad range of information-gathering, inspection and enforcement powers.

Only entities that reduce their emissions below their 'historic baselines' will be eligible to receive funding for projects. This standard will require the regulator to set baselines for a range of projects, over many sectors of the economy, and taking into account vast geographical differences. This is an enormous task – with the regulator potentially having to set thousands of 'baselines'.

Regulation will also need to deal with other complexities. For example, setting historical emissions baselines is simply not possible for new operations due to the lack of historical data. It is also problematic when businesses expand, or start producing different products. To deal with these situations, a 'best practice' emissions intensity approach has been suggested. 'Best practice' is an extremely vague and dynamic concept. There is no doubt that a significant amount of regulation will be required to establish what this means, and how it will be applied to individual businesses.

Of course, it will be possible to take advantage of this complexity. Despite guidance from the regulation, the regulator will need to come to a subjective judgement for individual businesses' level of 'baseline' emissions. Entities will attempt to obtain the highest possible 'baseline' or 'best practice' level of emissions. By starting from a higher point, a fixed cost emissions reduction project will have a lower auction price – making their bids more competitive, and more likely that it will receive project funding. Alternatively, the government could use the same method to game the system and pick winners.

There is a real threat that the Direct Action policy will become a quasi 'industry assistance' or 'co-investment' scheme to prop up failing companies in the name of reducing carbon emissions.

At least the Button car plan had the nobler goal of protecting jobs.