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Australia's low pollution future: economic reform to tackle climate change

Australia Business Economists lunch

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Introduction

It's a particular pleasure to be here again to address the Australian Business Economists.

Climate change is an economic challenge – and the solutions to that challenge require a coordinated response to reform and transform the Australian economy. This response makes demands of government, businesses, policy makers, the voluntary sector and households. We all need to play our part to secure the low pollution economy of the future.

Addressing climate change requires a real commitment to reform. Reform on this scale will affect our entire economy and the challenge for the world is to find ways to reduce emissions at the lowest possible economic cost.

That is why the Rudd Government is introducing the Carbon Pollution Reduction Scheme in 2010. The longer we delay action the higher will be the overall cost to the Australian economy. Through the Scheme, we will start reducing Australia's carbon pollution from next year.

Tackling climate change and the global financial crisis

There is no doubt that the current global economic conditions pose a major challenge to building a global agreement on climate change.

Recent developments in the international economy have been dramatic and fast moving. Major economies around the world, including many of our trading partners, have moved into a serious downturn.

Australia is not immune from this global crisis.

But we cannot allow the global financial crisis to weaken our determination to address the very real and long-term threat that climate change poses.

Deferring action at this point would increase investment uncertainty at precisely the wrong time.

Like the response to the global financial crisis, our responses to climate change will require coordinated action among a large number of the world's economies.

Further, in these times of economic uncertainty, it is even more important that we put in place policy responses that reduce our emissions at the lowest possible cost and in the most economically efficient way.

That is why we have chosen to implement a cap-and-trade emissions trading scheme – the Rudd Government's Carbon Pollution Reduction Scheme.

Cap-and-trade addresses the failure to impose a price on the emission of greenhouse gases into the atmosphere. Carbon pollution is a classic example of an environmental externality, no doubt very familiar to members of this audience. For too long, the costs of climate change imposed on the community have not been taken into account in investment, production and consumption decisions.

At its core, the Carbon Pollution Reduction Scheme creates a price signal which will drive incentives for businesses, governments and consumers. For the first time in Australia we will create a market which will drive reductions in carbon pollution. This will be a powerful mechanism to change the way we allocate resources throughout the economy.

The Carbon Pollution Reduction Scheme will open up new industries that will be the key to sustained prosperity in a carbon constrained world. The economic modelling undertaken by the Australian Treasury demonstrated that reducing our carbon pollution will see the renewable energy industry grow to 30 times its current size by 2050, creating new jobs in solar, wind and geothermal technologies.

Given recent global market turbulence, it is reasonable to consider what lessons we must bring to the task of designing an emissions trading scheme.

Tackling climate change demands that we build the low pollution economy of the future. We need a robust vehicle to drive the scale of investment required to achieve this economic transformation.

The Government remains of the view that a cap-and-trade market mechanism is that vehicle. Consistent with the Government's broader philosophy on markets, the Government has set out a range of measures in the Carbon Pollution Reduction Scheme to guard against manipulation and market instability, including banking and borrowing, international linkages, and careful market design and oversight arrangements.

The Government maintains the view that the introduction of a carbon price is essential to drive the necessary investment that will move Australia to the low pollution economy of the future.

The Government considers other emissions reduction policy mechanisms to be inferior when compared to cap-and-trade emissions trading.

The development of a robust and well regulated carbon market provides a solid framework and strong incentives to unleash the creativity and talent of Australian businesses in a way which cannot be achieved by regulation alone.

It will inspire companies to find new and innovative ways to reduce their emissions and spur investment in new, low emission technologies.

Alternative policy responses

In December last year, the Prime Minister launched the Government's Carbon Pollution Reduction Scheme White Paper. The White Paper outlines the final design of the Carbon Pollution Reduction Scheme and decisions on other significant climate change programs. The exposure draft legislation for the Scheme will be released in the very near future and we will seek the support of the Opposition and minor parties to pass the Scheme through Parliament this year.

The benefits of the cap and trade approach that underpins the Carbon Pollution Reduction Scheme have been well traversed in numerous reviews over several years, by governments of every stripe. Indeed, the former Government issued a series of discussion papers - as long ago as 1999 - setting out the key features of an Australian emissions trading scheme.

So we have long known this is the path we need to take.

Unfortunately, it has taken until now for a Government in Australia to embark on that path and demonstrate the commitment required to legislate an emissions trading scheme.

Despite the steady accumulation of evidence that emissions trading will deliver lowest cost and the most economically efficient reductions in carbon pollution, some commentators have recently called on the Government to switch course and adopt a different policy mechanism.

Let me be absolutely clear: our Government remains undeterred in our determination to implement the Carbon Pollution Reduction Scheme because we know it is the economically responsible course of action for Australia.

Let us remind ourselves again of why this is the case.

First, the cap provides a clear and transparent means of delivering a quantitative target. It is inevitable that international and domestic action will be framed by the ultimate objective to reduce carbon pollution. A cap and trade system can provide this certainty. The other major approaches to reduce carbon pollution – such as carbon taxes or regulation - cannot. In other words, with policy mechanisms other than cap-and-trade, there is no way to guarantee emissions will actually be reduced.

Second, enabling trade in pollution permits ensures carbon pollution reductions occur at the lowest cost. Trade allows the market to find the lowest cost abatement opportunities, and allows the carbon price to flex with economic activity. While a carbon tax can theoretically provide the same outcome, it relies on governments to decide on the appropriate price to meet a given outcome. As economists, you will understand that Governments simply do not have this information.

Third, the creation of a predictable carbon market provides a means for business to manage carbon risk. Other arrangements leave business open to abrupt and unpredictable changes in policy which undermine investment certainty.

And finally, for all the reasons I have just outlined, cap-and-trade is emerging as the dominant response internationally, opening up opportunities for linking of carbon pollution reduction efforts. Emissions trading will be central to global efforts to reduce carbon pollution. A carbon tax or regulatory mechanism would not allow Australia to take advantage of emerging international economic opportunities.

Australia cannot afford to be left behind, and indeed has a key national interest in moving forward with sensible and deliberate action.

Despite the desperate cries of the Coalition's climate change sceptics, in Australia, the time for debate is drawing to a close. We must now take the responsible course of action and start reducing our emissions. Under the Carbon Pollution Reduction Scheme, Australia will start reducing emissions from next year.

Initiatives without economic reform

In a recent speech to the Young Liberals Convention, the Leader of the Opposition outlined a set of measures including storing carbon in soil, revegetation, biochar, improved energy efficiency for buildings and investment in new energy technologies.

These technologies and actions have the potential to make a valid contribution to the task of reducing Australia's carbon pollution, but Mr Turnbull unfortunately continues to equivocate on how he would actually drive the take-up of these activities.

Despite strongly supporting a cap-and-trade scheme when he was Environment Minister and continued support for emissions trading up until last year, Mr Turnbull still refuses to indicate whether the Coalition will support the Carbon Pollution Reduction Scheme.

Mr Turnbull has let emissions trading become the elephant in the Coalition party room.

Indeed, Mr Turnbull's prevarication on the CPRS can only be explicable in terms of Liberal Party leadership tensions, because it is certainly inexplicable in terms of good policy.

And just this week, we have seen the Opposition's spokesman on emissions trading talking up the merits of a carbon tax over emissions trading.

That is to say that senior members of the Coalition are considering a new tax that cannot guarantee reductions in Australia's carbon pollution as a alternative to supporting the Government's Carbon Pollution Reduction Scheme that will reduce Australia's emissions from next year.

The initiatives outlined in Mr Turnbull's speech to the Young Liberals conference contain no policy detail, no costings and - most importantly - they contain no central mechanism to achieve the carbon pollution reductions Mr Turnbull talks about. Having held the position of Environment Minister, Mr Turnbull knows that emissions reductions don't occur simply by talking about them.

Unfortunately, as I have said, the Liberals' response to climate change is a proxy for the Party's leadership tensions.

The Liberals know they can no longer afford to be seen to be climate change sceptics, but the reality is that sceptics are still running the Liberal agenda. And despite his long standing support for cap and trade, Mr Turnbull hasn't demonstrated the ability to rein in these sceptics.

So rather than actually support a policy that will really deal with climate change, they release decoy policies to create the impression they are serious.

The carbon tax is a perfect decoy. It is not going to happen. Andrew Robb and his sceptic friends know it is not going to happen, so it is perfectly safe for them to promote it.

Likewise, the measures Mr Turnbull announced enable him to talk the talk on climate change, without taking any leadership to override the sceptics on his frontbench.

Mr Turnbull argues that the land-based emissions reduction measures he has proposed could deliver 150 mega tonnes of abatement a year by 2020.

It is important to note here that Mr Turnbull talks about some technologies, such as biochar that – while promising – have not yet been proven at scale anywhere in the world.

It goes without saying that we all want biochar to be a success story and that's why the Government continues to invest heavily in researching new technologies.

But if biochar doesn't stack up and we had to rely solely on reforestation to achieve 150 megatonnes of abatement per year by 2020, we would need start now with an unprecedented tree planting exercise.

Based on moderate calculations, Mr Turnbull's policy would require planting trees covering half the land mass of Tasmania - every year - for the next ten years.

Even if we put aside the enormity of the task Mr Turnbull is proposing, it is very difficult to believe he could be serious about such a large scale transformation of the Australian landscape, given the strong objections to planting carbon forest sinks within his own Coalition.

So once again, this is a decoy – a decoy designed to cover Mr Turnbull's tracks as he attempts to crabwalk away from a real answer on climate change.

What Australia needs is a coherent and practical strategy to address climate change. We need to move beyond piecemeal responses and put in place an economic transformation that can move Australia to the low pollution economy of the future.

That is why our Government is getting on with the job of introducing the Carbon Pollution Reduction Scheme.

The Carbon Pollution Reduction Scheme

I would like to spend a short while outlining some of the main aspects of the Scheme.

The Carbon Pollution Reduction Scheme has ambitious targets and a wide scope covering the majority of Australia's carbon emissions – around 75 per cent – across sectors including stationary energy, transport, fugitive emissions, industrial processes and waste.

The majority of permits will be auctioned from the start of the scheme, and we propose to move over time to full auctioning of permits. Importantly, the Australian Government has committed all funds raised by the sale of pollution permits to help households and business adjust to the Scheme.

The Government proposes a combination of firm scheme caps, set five years in advance, with a gateway extending 10 years beyond the cap to provide markets with a degree of certainty on future caps. The Scheme caps and national targets will play an important role in determining future carbon prices.

What is less understood is the central role of the international carbon market in determining carbon prices.

Australia's Carbon Pollution Reduction Scheme has been designed to link in with existing Kyoto mechanisms and to eventually link with other international schemes as these schemes are implemented and mature. This will reduce the overall cost to the Australian economy.

As in other areas of economic life, participants in the market will need to pay careful attention to international carbon market dynamics rather than focussing exclusively on the domestic market.

In addition to the scheme caps and international linking, the forward carbon price will also be influenced by other Scheme features including the rules for banking and borrowing and rules about international linking. The Scheme will also contain a time limited price cap designed to prevent extreme prices within the scheme and to provide business with certainty over the maximum level of compliance.

We also propose to address the potential problem of carbon leakage. Transitional assistance in the form of free permits will be provided to the most emissions-intensive trade-exposed activities.

Managing this important structural change at the lowest cost is the tough job of economic reform that this Government is taking on.

Modelling

The Scheme design is also backed up by robust and credible long-term modelling by the Australian Treasury.

This modelling concluded that responsible action now is less expensive than later action. It also concluded that strong coordinated global action reduces the economic cost of achieving environmental objectives, reduces distortions in trade-exposed sectors and provides insurance against climate change uncertainty.

The modelling shows that we can still reduce our emissions while continuing to grow our economy. Acting now to reduce emissions will be cheaper than acting later or even worse not acting at all.

Crucially, the modelling suggests that real GNP per capita growth slows by one tenth of one percent per year as a result of putting a price on emissions.

This is one fifth of the cost of population ageing. Moreover, this does not take into account the costs avoided by successful global action on climate change. The Government accepts the findings of the Garnaut Review that the costs of inaction will be greater than the costs of action.

Developing Australia's carbon market – creating opportunities for businesses

As outlined in the White Paper, an effective global carbon market will play a key role in developing sound international solutions to climate change by fostering least-cost global abatement.

In Australia, the Scheme will create new types of financial product. Over time, these will be traded on world markets.

Australia is well placed to provide the necessary services to support developing carbon markets in the Asia-Pacific region.

We are a regional commercial centre with world-class financial institutions, developed capital markets, a skilled workforce, high standards of corporate, financial and regulatory governance and political stability.

The potential value of such a hub in Australia could have significant benefits for our economy.

Globally, countries that have begun early the transition to a low carbon economy will develop the innovative businesses and specialised expertise to help other economies with their transition.

This will deliver substantial investment in clean technologies that enable us to maintain and improve living standards while reducing our impact on the climate.

As I have already highlighted, if we are going to truly tackle climate change at the lowest cost, we will need to harness the full power of market forces.

Complementary measure - fast tracking the low pollution future

And as I have said, the Australian Government views the Carbon Pollution Reduction Scheme as the central means of reducing carbon pollution.

And we also recognise that there are a range of critical complementary policies that need to operate alongside emissions trading. These policies will fast track the introduction of low emissions technologies.

As part of Australia's move to a low pollution future, the Government has committed to a 20 per cent Renewable Energy Target, new Solar Credits, investment in carbon capture and storage demonstration and action on energy efficiency.

The Renewable Energy Target will ensure 20 per cent of Australia's electricity – the equivalent of all household electricity consumption - is sourced from renewables by 2020, helping us build the low-pollution economy and jobs of the future.

Energy efficiency also forms an important element of the Government's emissions reduction strategy. This is why, as part of its fiscal stimulus response to the global financial crisis, the Australian Government has included energy efficiency and renewable energy measures. The effect of these measures announced in the recently passed, \$42 billion, stimulus package is estimated to contribute to meeting Australia's greenhouse gas emissions reduction target by over 40 million tonnes by 2020.

The international climate change agenda in 2009

We must recognise that any action that Australia takes must be placed in an international context.

2009 represents the second half of the two year Bali Roadmap process agreed by countries in December 2007 and will be an intense year of negotiations leading up to the 15th Conference of the Parties in Copenhagen at the end of this year.

In Copenhagen we will be seeking a comprehensive and effective agreement that sets the world on a path to reduce emissions and to avoid dangerous climate change. Australia believes it is possible to secure an agreement that achieves this objective while maintaining economic development.

The Australian Government is committed to playing its full and fair part in global efforts to address climate change.

Establishing the CPRS will be a key element in Australia's positioning. What all sides of this debate need to understand is that failure to demonstrate credible and decisive action through the passage of the CPRS legislation will seriously impact on our international position – and, in turn, have a detrimental effect on getting the global solution we need.

Conclusion

The Australian Government remains committed to tackling climate change in tandem with its response to the global economic and financial crisis.

Our response goes beyond a shopping list of interesting ideas about individual technologies and abatement actions. To achieve meaningful reductions in emissions in accordance with our tough targets will require a comprehensive and consistent approach. The time for piecemeal approaches which are ineffective and inefficient is over.

Likewise, it is time for the curtain to close on Mr Turnbull's Hamlet soliloquy on climate change.

The response I've outlined this afternoon represents a comprehensive, well thought out and structured approach to climate change, backed up by robust and credible Treasury modelling. The introduction of a carbon price through the CPRS provides the economic incentives, the complementary measures will fast track many new and exciting technological developments. This means we are ready to play our part in the international negotiations to secure a workable global agreement and to position our economy for the future.

The Government has stated its strong commitment to doing our part to tackle climate change with ambitious, but achievable targets, and robust and credible framework which will reduce our emissions at the lowest overall cost to the economy.

In these times of economic uncertainty now is not the time to falter or delay the introduction of this crucial economic reform.