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CEDA
COMMITTEE FOR ECONOMIC DEVELOPMENT OF AUSTRALIA

State of the Nation

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Well thank you very much this reminds me that I spent five and a half years doing a PhD which took 680 pages which I made into a book and now when people say what was your thesis about I can describe it in one sentence so what I'm going to try and do in about 15 minutes is give you a summary of seven months very intensive work by the Emissions Trading Task Group which I had the honour to Chair and I suppose let me start by giving the graph that everybody knew right at the beginning when it indicates of course that Australia is on target to meet its Kyoto target that is of 108% of 1990 levels between 2008 and 2012 but it also shows of course that by 2020 if we don't take further action then our emissions are likely to continue to rise.

Now we spend a lot of time talking about the issues of emissions trading. I suppose I could summarise it there were three things we came to know during this six months. The first which is on the screen, that we in all likelihood will meet our Kyoto target. We will meet it through some relatively low cost measures which are also let me remind you very good policy as such as reducing land clearing but the problem with that is it tended to be one off. The group was also of the view that there had been many other measures introduced which have helped us to meet this target but a number of them such as mandatory technology, renewable technology targets provide abatement and in fact very high cost and one thing we were determined is that what Australia needed to do, if you believe in impact of climate change, if you want to protect yourself, if you want to manage the risk that faces future generations by bringing that risk forward onto our shoulders that we need to do it at least cost.

The second and you all know this is Australia can do bugger all on its own where 1½% of the worlds emissions by 2050 will be at 1% of the worlds emissions. So unless what we do here can help to strengthen our effectiveness internationally and allow us to become part of a global arrangement it's not going to mean very much. It may make us feel good but it's not going to have any significant effect on mitigating the emission of greenhouse gases. So we need to be part of acting globally and again the task group were unanimous in the view that Kyoto was not a strong basis for moving forward into the future not least of course because it really doesn't involve in a coherent way developing countries but our view was we couldn't certainly just wait until there was a global scheme in place and then say Australia will join. And the reason we don't think we can do that is twofold. First we don't anticipate there is going to be a post Kyoto comprehensive global agreement in the near future. What you are going to see internationally is a patchwork of different emissions. Some will be called climate change of different policies. Some will be climate change, others will be called energy security, some will be called sustainable development, some will be about emissions trading and some will be about forest stewardship and some will be about technology partnership. There'll be a mixture of bilateral and multilateral and pluralateral and regional arrangement. It is going to be a mess for a few years

internationally. There isn't going to be, we don't believe in 2012 sudden announcement a comprehensive global agreement. There might be, it would be good but it's unlikely but the view is therefore we couldn't wait for a global agreement and more than that it was clear to us from all the consultations that we were doing with industry that there were increasing costs to uncertainty about what Australian government policy was going to be and so that's why as a group we came to the view that we couldn't wait for the development of a global agreement. We needed as a country to set our own long-term aspirational goal to reduce emissions, find the least cost way to achieve that goal and in our view, in our view that was clearly to use the market, to use the market to drive a price for carbon, to drive technology change to get us the least cost not the no cost but the least cost emissions reduction and that of course to be accompanied by a very active international strategy.

So how do we think it's going to work? Well this is our views. First of all the government needs to set a long-term aspirational target and it is now committed to doing so by the middle of next year. This is a target for let us say 2050, 2060, it's got to be long enough to be the lifetime of an investment. In other words its got to be 30 or 40 years. That's the first thing, the aspirational goal.

What the government then needs to do is to say well what are going to be the emissions for the first ten years and its got to do that very specifically. We're suggesting a scheme that would come in in 2011. So the Australian government will set the emissions target for 2011 will be this, 2012, 2013. So for the first ten years you know specifically what the targets are. Our view is that you should move only slowly away from business as usual. So in other words you slow rise then stabilisation and then a downwards trajectory. And this I suppose is one of I think the most innovative features of the scheme we're proposing. The government should also set if you like a range of targets for the next ten years. So you know the aspirational target let us say for 2050, you know the emissions levels that are being set for the first ten years 2011 to 2020 and then it sets a gateway as you can see up there for what might be 2025 and another gateway for 2030. So that business knows not exactly what the emissions is going to be, the targets set by government for 2025 but it knows there will a minima and a maxima and then what we're saying is each five years government can calibrate and move forward another five years. You see what you're getting is not only an aspirational target but a real sense of the trajectory.

Now the likelihood not the certainty but the likelihood is that over time governments are probably going to go for the lower point of the gateway, that is to say progressively tighten the amount of emissions that can be put into the atmosphere by Australia. It could go the other way. Maybe we'll find for example there is simply no international agreement and that Australia is punishing itself economically for nothing. Perhaps we'll discover all the science is dead wrong and we start to go into a period of global ice age but the point is the likelihood is that governments will progressively tighten the trajectory down to that aspirational goal.

Now what you of course do once you've got a trajectory that in effect drives a forward price curve for carbon. Now let me say this and I think you'll all understand it but some of my audiences don't. The government is setting the emissions targets. The market is setting the price because somehow some people were thinking the government is going out there and saying what the price is going to be of carbon in 2011 and 2020 and 2050, it's the market that does that. You will get a forward price curve, it will go up. In other words if emissions are being reduced the price of carbon is going to be going up. Now one of the things we wanted to avoid, one of the reasons we are saying for goodness sake take three years to get this right. One of the things we want to make sure is you don't immediately have the sort of wild fluctuations we've seen with the European scheme. And remember by the government now in bracing this approach it really has set us near the front of the rest of the world and I'll come to how ambitious this is in a moment but what we're saying is we need a bit of certainty during those first few years.

One way is by only slowly moving away from business as usual and the other is by use of the emissions fee. The emissions fee from let us say about 2013, 2014 is going to be a compliance requirement. In other words if you emit more greenhouse gases than you've got permits for you will pay a penalty and that's the emissions fee and obviously the emissions fee has got to be higher than the price of carbon because otherwise people will say well we won't reduce our carbon we'll just agree to pay the fee. But what we're suggesting is in this first two maybe three years will set the emissions fee only slightly above the carbon price. In effect in those first few years it effect acts as a maximum price. In those first few years it is almost a mix, a hybrid if you will between emissions trading and a carbon tax. So that's how we're suggesting and we are saying and I think this should have knocked peoples socks off but it didn't but we are saying go big. If you're going to have an emissions trading system and we think we should have and the Australian government has now accepted this you need to cover as much of the economy as you can because if you don't that part of the economy which is subject to emissions controls will pay a higher price relative to that part of the economy which is not covered. So we've gone wide. We have said if we are going to do this we should start from the premise that essentially we cover 100% of emissions except where we have very high administrative compliance costs. We are going for a system which we think will cover about 70% to 75% of Australian emissions from introduction in 2011.

How does that compare? Well compared with the state scheme, the state scheme was looking at 35% to 45% of emissions. European scheme 45%. Our schemes looking at 70%, 75%. This is ambitious. The reason we're saying lets move cautiously to set this up by 2011 isn't because I was the Chair of a task group which was looking to procrastinate it was because I was the Chair of a task group which was trying to be bold in the scheme that we wanted to introduce.

In terms of the large facilities the good news is we think there's about 900 facilities in that produce about 25,000 tonnes of carbon a year. If we apply emissions trade into those 900 firms that will cover about 80% of the emissions in that set. Of course small business will not need to go and get emissions permits but will be subject to this because they'll be paying more for their fuel, they'll be paying more for they're energy. In terms of fuel this is the big difference, in our view looking at Australia and this an emissions trading scheme which is designed for Australia. In our view fuel should be in and the way you deal with fuel is by imposing the constraints on the fuel distributors. Small businesses in households have no direct liability but will suffer the prices income. Initially and I emphasise initially we will be looking to not include agriculture or land use or waste and it's simply because the data we've got on that at the moment is not sufficiently good. In our view agriculture should be brought into the system. At the moment we don't think it can be done by 2011 but of course agriculture becomes very important in terms of the carbon offsets that may be offered in the scheme.

How are these permits going to be allocated? Well there's going to be three different ways and again let me go back, government sets targets, market sets carbon prices and independent regulator does the allocation and oversight of permits. Essentially we're saying look at the Australian economy, look at firms and we will pay a compensation, a once and for all once off compensation for those firms that suffer a disproportionate loss. Now remember this, one of the things we tried to write is an eyes wide open report. Emissions trading, managing the risk of climate change, costs, you will pay more for fuel, you will pay more for energy, it will impose costs on economic growth. It is the way we manage those costs to get them as low as possible but some firms, all firms will suffer some sort of loss probably but we're looking here at compensating firms that suffer a disproportionate loss.

What do I mean? Well let us imagine that you're in a firm where your net income stream is going to be reduced by 20% as a result of emissions controls. You don't get compensation in the form of a package of permits for 20%. We are looking for disproportionate loss. So let us imagine that we do the calculations and we find that the aggregate cost to the Australian economy is 5%. The disproportionate loss for your firm is therefore 15% and you will get a free allocation of permits in recognition of that

disproportionate loss. So you will get a bucket of permits. Some will be for 2011, some for 2015, some for 2020, some for 2030 who knows and that's once and for all.

Then there will also be a free allocation of permits to the trade exposed emissions intensive industries. Now this is pretty important. There is absolutely no point in beating ourselves up or beating our trade exposed emissions intensive industries up. In driving production overseas in a way that doesn't actually help to reduce global emissions one bit. So whilst our trade exposed emissions intensives are not on a level playing field with the rest of the world for this transition period they too get a free allocation but they're free allocation continues as long as there is not a global arrangement in place for their industry sector. We still of course want to push those trade exposed to have better less carbon technology and therefore what we're suggesting over time is if you want to get more permits to expand your plant the number of permits will be given will be based on worlds best practice and again all of that is designed to push even these industries into having an economic reason why they want to improve their technology and then the remaining permits over time will be auctioned through an independent regulator.

Now this slide isn't in, the emissions trading report but it's a neat one, it's got lots of colour and I'll give the movement. The blue here is these one-off compensation permits. You'll notice this is a very carefully drawn graph. This is the public service at its best. Its got no timeframe, its got no amount of emissions and even the line of reduction you couldn't draw too much from but what you've got is a reduction in emissions over time. The brown at the top is that part of the economy we're not including at the beginning, agriculture, land use. The blue is the number of permits that we're giving as compensation, we'll probably give more for 2011 and we give very few for <inaudible> okay but essentially you've got a package of permits. The yellow is what you give for the trade exposed and as I've said that allocation will continue for a long transitional period as long as our industries are competing not on a level international playing field but they will reduce over time.

Now the bit that is probably interesting you, I imagine the bit that interests any government is the red bit in the middle because of course this is the amount of permits that will be available for revenue and it is clear that whilst in the first year it will be small, it has the potential to rise quite quickly and therefore our task group said what shall we do with that? Our view is we are only going through this exercise in order to try and reduce emissions and try and do so by the improved development and adaptation of technology and our view therefore is that the revenues that come from this should contribute quite directly to that. So in our view these are revenues which should go to help to research and develop and demonstrate low emissions technologies. We are talking about here helping industry at the pre-commercial stage to help to drive this technological change, measures to address significant market failures, assistance to households. This is the one thing on which I think we are pretty clear that we not necessarily know what the government should do but we're bloody certain what the government shouldn't do and what the government shouldn't do is simply use the revenues to subsidise the power bills of individual households. Now in case that sounds a bit mean again think what we're trying to do here. We are trying to change the behaviour of industry and households. If you simply go in and subsidise the energy bill of households you won't get behavioural change. Those that have support for households should be if government wants to do this, helping them, informing them, subsidising them perhaps to take measures which will reduce their use of energy and emissions intensive energy. So that's what we think of in terms of complimentary measures. We don't stand up, I don't stand up in here and say brothers and sisters we have found the answer is emissions trading, we think it is absolutely the foundation because we believe in the market and the best way to do it is through the market but there is clearly a need for complimentary measures and I've set them out. What we don't believe however is having measures which don't just address market failures but are in fact very expensive and that's why in this I suppose in this is part of the controversy in this report, we do not support continuation of mandatory renewable schemes.

What have we got against renewables? Nothing, nothing do we have against renewables. I reckon geothermal and solar, may be part of the solution for the future. Just in the same way as clean coal and nuclear may be part of the solution for the future. What we're saying is the decider should be the market. We are only doing this for one reason. We are not doing this to promote wind power. We are doing it to reduce emissions at least cost and if wind power is the answer, that's great. The market will see that.

Timeframe, we think three and a half years this is where we seem to go slow. I hope this little chart will just show you what has got to be done. We're saying that from the next year, year and a half there's a huge amount of work that has got to be done in finalising the design of the scheme. Just about every question you're going to ask me, I'm going to say I don't know we're going to decide this in the next 18 months.

We need to get an emissions reporting scheme up and running. We need to set the long-term aspirational goal, engage our international partners. Then in 2009 we've got to get the legislation through, establish the government structures including the independent regulator, broaden international cooperation, rationalise government programs. I don't know how much this independent regulator is going to be paid but it is not going to be enough.

This is going to be a very difficult few years. Perhaps I'm wrong. Perhaps I have been in the public service too long and become cynical but I suspect that a lot of industries are going to think they're trade exposed emissions intensives and if they're not they're going to think they suffered disproportionate loss and it's going to be a quite hard, challenging few years to set those permit allocations through the independent regulator. We got to rationalise government programs and then in 2010 we'll have the short-term targets, the allocation of the permits and commence trading at the beginning of 2011 and obviously right through this explore linkages with other countries.

So we think on the task group that this is one of the most innovative examples of such a scheme in the world, genuinely believe that. More comprehensive than emissions trading schemes introduced or proposed elsewhere. To commit ourselves would position us ahead of most of the world and of course I wrote that graph on Friday and on the Sunday, the government accepted the conclusions of the task group. What we wanted to do was think big, commit early, design carefully, act deliberately and then implement cautiously. I hope that's been helpful.

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