

A CARBON POLLUTION REDUCTION SCHEME FOR AUSTRALIA

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Introduction

In February this year, in my first major speech as Minister, I defined the response to climate change as a responsibility agenda.

It is a responsibility agenda in many ways.

It is about taking responsibility for what we are doing to our planet.

It is about taking responsibility for preparing for the future.

And it is about taking responsibility for protecting our economic prosperity.

This is not an abstract discussion about competing scientific theories.

It is no longer simply a discussion about what climate change may one day do to our natural environment. It is a recognition that climate change is already occurring.

It is an acknowledgement that Australia has a great deal to lose from climate change and we must act now to protect our prosperity and our way of life.

We confront a daunting reality: we cannot continue to pour carbon pollution into the atmosphere as if there is no cost.

This is not an emotional plea to abandon our self interest in favour of ecological concerns.

Quite the contrary. It is in our self interest to take on climate change, even if this is not easy.

Two weeks ago, Professor Garnaut released the compelling draft report of his climate change review.

If there is one message from Professor Garnaut's report, it is that failure on climate change is not an option for Australia.

The twelve hottest years in history have all been in the last thirteen years - and IPCC scenarios predict temperature rises between 1 and 6.4 degrees over the next century relative to the period 1980-99.

Without action, scientists predict up to 20 per cent more drought months over most of Australia by 2030, more intense and damaging cyclones and rising sea levels with serious impacts at home and on nearby, low lying Asian mega cities and Pacific Islands.

As one of the hottest and driest continents on earth, Australia's economy and environment will be one of the hardest and fastest hit by climate change if we don't act now.

The nation's food bowl, the Murray Darling Basin, is seriously up against it. This year's June inflow was a new record low of just 95 billion litres, down from last year's previous record low of 106 billion litres, and less than one sixth of the long term average of 680 billion litres.

Climate change threatens our food production, agriculture, and water supplies, as well as icons like the Great Barrier Reef, the Kakadu wetlands and the multi billion dollar tourism industries they support. Over 700,000 coastal addresses worth tens of billions of dollars are at risk of significant damage from extreme weather events.

Today we are already beginning to feel the economic and environmental costs of inaction on climate change. But if we delay action any longer, these costs will be felt even more acutely not only by our generation, but also our children and grandchildren.

Today, the Rudd Government's response to climate change enters a new phase.

Today we point the way to a low-pollution economy of the future, to transform the high-pollution economy of the past.

I am releasing the Rudd Government's Green Paper on the Carbon Pollution Reduction Scheme – a scheme which will reform and transform the Australian economy.

The Carbon Pollution Reduction Scheme is a response to climate change that is economically responsible, supports families and prepares Australia for our future challenges.

This Green Paper sets out options, and identifies the Government's dispositions and preferred positions, on emissions trading and the support we will provide to help households and businesses adjust to this economic transformation.

The Carbon Pollution Reduction Scheme

Climate change is being caused by the ceaseless pouring of carbon pollution into the atmosphere.

If we are going to tackle climate change, we need to reduce carbon pollution dramatically – which is much harder to do than it is to say.

Over time – but starting now - we need to move toward the low pollution economy of the future.

That will require substantial investment in clean technologies that enable us to keep improving living standards while reducing our impact on the climate.

And it will require us to dramatically increase carbon productivity – the output per unit of carbon emitted. Put simply, we have to get more out of the carbon we use.

The Rudd Government has set a clear long term target on climate change, to reduce Australia's emissions by 60 per cent of 2000 levels by 2050. Looking at our current emissions trajectory, it is clear that meeting this target will be a great achievement.

Clearly, all of us – governments, industries, individuals - will need to do more if we are going to tackle climate change and move to a cleaner future.

And to realise this greater ambition, to meet this challenge, we need to transform our economy.

As Nicholas Stern put it, climate change represents the "greatest market failure the world has seen", because the market has never taken account of the cost of carbon pollution.

In other words, there has been no cost to producing carbon pollution and no limit to how much we can produce.

The effect has been to create a perverse incentive to pollute the planet, because on the face of it, the cheapest way to fuel our economy has been with carbon producing fossil fuels.

But in reality, this has not been cheap at all, and the cost is now being realised.

The wrong incentives in the market have driven climate change. If we are going to truly tackle climate change, we will need to harness the full power of the market in correcting these incentives.

This requires a market-based reform – which is why we need emissions trading. And this is why emissions trading is at the heart of our comprehensive Carbon Pollution Reduction Scheme: a whole of economy reform which works as follows.

- The Government sets a limit on how much carbon pollution industry can produce, and then the Government sells permits up to that limit, creating an incentive to look for cleaner energy options.
- Companies can buy and sell permits from each other depending on how much they value them, thereby enabling the market to find the most efficient ways to reduce carbon pollution.

While this is the most efficient, lowest cost and most economically responsible way to reduce carbon pollution, it is not without costs. There is no cost free way to tackle climate change.

This is why a key element of our Carbon Pollution Reduction Scheme is to ensure that every cent raised from the selling of permits will be used to help households and business as they make the move to a clean energy future.

The effect of putting a price on carbon will be profound. Indeed, in its ability to change the economy over time, the Carbon Pollution Reduction Scheme is likely to be on par with past economic reforms such as the reduction in tariffs or deregulation of the financial system.

Placing a limit and a price on pollution will change the things we produce, the way we produce them, and the things we buy. It will open new doors to a cleaner energy future.

It affects relative prices in the economy, so that those goods and services which are carbon intensive cost relatively more over time than those that are low carbon.

The market will reward companies and industries that find ways to produce their goods in a way that contributes less carbon pollution to the atmosphere.

And with a market based approach, consumers still get to choose what they consume.

By harnessing the market in the effort to tackle climate change, we are creating enormous opportunity for growth in a world where carbon is constrained.

The tough economic reforms of the past – opening up the economy, floating the dollar – mean Australia is now well placed to undertake this tough new reform.

Like those reforms, like our agenda to increase productivity with investment in skills and infrastructure, the Carbon Pollution Reduction Scheme will modernise our economy for the future and protect our standard of living.

Consultation

Over the past six months, I have been engaged in ongoing consultation and discussion with business and the community.

It is clear to me from my discussions that both are well and truly on board with the need to tackle climate change. It is widely understood that this will be a tough economic reform, but that there is a necessity for a market based transition to a low carbon future.

Many businesses have made it clear they would like assistance for their circumstances. The Government has listened carefully to those views, and we will continue to engage closely with business as we finalise our approach.

But I would like to explain the Government's challenge here. As I said, once we agree to reduce pollution and introduce emissions trading (and there is strong consensus around that), we need to make it as broad as possible to minimise the costs.

So if you are to exclude certain sectors, that means the same overall carbon pollution reductions need to occur with a smaller pool of contributors.

Likewise, any arrangements to give assistance to one sector means another sector has less.

The economics of carbon reduction have an inexorable logic. None of the decisions is isolated. They are all linked. Giving relative priority to one or another inevitably involves a trade off.

We are engaging in a careful and methodical process, including undertaking one of the biggest economic modelling exercises in Australia's history, and extensive consultation that will continue well beyond today, before finalising our decisions later in the year.

In this Green Paper, the Government has sought to strike the right balance, on the basis of economically responsible policy in the national interest.

Guiding our approach is the unavoidable reality that the costs of inaction are greater than the costs of action. Moreover, the longer we delay, the greater the cost. This is why we intend to implement the Carbon Pollution Reduction Scheme in 2010.

The Government's directions

Coverage

There has been much talk about what's 'in' and what's 'out' of our proposed scheme – what we call 'coverage'.

Generally that discussion has been focused on whether petrol is in or not. This is a Government that understands Australians are struggling with rising petrol prices.

However, it does not actually help the circumstances of Australians struggling with petrol prices if transport emissions are not included in our scheme.

That's because, as I just said, regardless of what sources of carbon pollution you include, we still need to make the same reductions across the economy as a whole. If we are going to reduce carbon pollution, as we need to, those reductions have to come from somewhere.

The best way to reduce carbon pollution is to spread the work across the economy, so all sectors of the economy are doing their bit.

The bulk of Australia's emissions come from electricity generation, transport and agriculture. In the interests of economic responsibility, we propose the Carbon Pollution Reduction Scheme will cover stationary energy, transport, fugitive emissions, industrial processes, waste and forestry sectors, and all six greenhouse gases counted under the Kyoto Protocol from the time the scheme begins.

The Government does not consider that it is practical at this stage to include agriculture emissions in the scheme. We recognise that considerable joint effort with the industry is still required to identify practical methods for inclusion, and to develop reliable and cost-effective methods of emissions estimation and reporting.

On that basis, the Government proposes that the earliest that agriculture should enter the Scheme would be 2015, with a final decision on inclusion or exclusion to be made in 2013 in the light of progress in overcoming practical difficulties and after extensive consultation with the industry.

Commitments in support of households

Families, pensioners and carers are foremost in the Rudd Government's considerations. They are under a great deal of pressure, with mortgage repayments, rent, groceries and petrol. In designing the Carbon Pollution Reduction Scheme, we have been extremely conscious of their interests now and over the long term.

As I have just outlined, our preferred option is to include transport emissions.

However, to offset the initial price impact on fuel associated with the introduction of the Carbon Pollution Reduction Scheme, the Government will cut fuel taxes on a cent for cent basis.

We will periodically assess the adequacy of this adjustment measure for three years and adjust this offset accordingly. At the end of the three year period the measure will be reviewed.

This commitment recognises that for this reform to be as smooth as possible, it needs to be as broad as possible. It also recognises that rising global oil prices are putting a great deal of pressure on Australian motorists. As demonstrated by a report from the CSIRO released last week, we need long term solutions on transport to reduce our reliance on foreign oil.

Our commitment to cut fuel taxes for the first three years of the Carbon Pollution Reduction Scheme on a cent for cent basis to offset the price impact on fuel will offer motorists five years to plan for potentially higher fuel prices.

Over this period, many people will have the opportunity to make decisions, for example, on the purchase of a new car - informed by the longer term implications of their choices.

In addition to assistance with fuel costs, the Government will increase payments, above automatic indexation, to people in receipt of pensioner, carer, senior and allowance benefits and provide other assistance to meet the overall increase in the cost of living flowing from the scheme.

We will also increase assistance to other low-income households through the tax and payment system to meet the overall increase in the cost of living flowing from the scheme.

Middle-income households will also receive assistance to help them meet any overall increase in the cost of living flowing from the scheme.

Every year, in the Budget context, the Government will review the adequacy of payments to beneficiaries and recipients of family assistance to assist households with the overall impacts of the scheme, noting that these payments are automatically indexed to reflect changes in the cost of living.

In addition to this direct financial support, we will provide assistance through the introduction of energy efficiency measures and consumer information to help households take practical action to reduce energy use and save on energy bills.

Tackling climate change will be hard and there will be costs, but we will help Australians every step of the way.

Commitments in support of businesses

Business will also gain significant assistance.

For heavy vehicle road users, who transport goods across the country, fuel taxes will be cut on a cent-for-cent basis to offset the initial price impact on fuel associated with the impact of the Carbon Pollution Reduction Scheme. The Government will review this measure after one year, giving the transport sector three years to plan how to reduce their emissions.

To assist rural and regional areas, the Government will provide a rebate equivalent to the fuel tax cut for businesses in the agricultural and fishing industries for three years.

The Government will establish the Climate Change Action Fund (CCAF) to help business transition to a cleaner economy, by providing in partnership funding for a range of activities, including:

- Capital investment in innovative new low emissions processes
- Industrial energy efficiency projects with long payback periods
- Dissemination of best and innovative practice among small to medium sized enterprises.

To ameliorate the risk of adversely affecting the investment environment, the Government proposes to provide a limited amount of direct assistance to existing coal-fired electricity generators. This is, of course, in addition to the Government's commitments to technological development, such as carbon capture and storage. The Government plans to deliver this new assistance, in part, through a new mechanism called the Electricity Sector Adjustment Scheme.

Different delivery mechanisms may be required for this support, which may include the provision of free permits.

Commitments to support emissions intensive trade exposed firms

We also propose to provide assistance to the most heavily emissions intensive trade exposed activities.

The extent of cost increases for businesses arising from the cap on emissions will depend on the emissions intensity of their activities. The more emissions they produce per unit of output, the higher the cost.

Many businesses will be little affected by the scheme, as they face the same cost increases as their competitors. However, trade exposed industries may not be able to pass on the costs as they face prices set in international markets, and compete against

firms that do not – at this stage – have comparable carbon constraints.

If these firms were to relocate elsewhere, with no consequent global reduction in emissions, it results in what is called ‘carbon leakage’. In other words, the carbon is still produced, just somewhere else.

Clearly, this is counter to our objective. We propose to address this potential problem by providing transitional assistance in the form of a share of free permits to the most emissions intensive trade exposed activities.

We will assist those firms that have a sufficiently material impact on their cost structures as a result of a price on carbon. We propose to use a measure based on emissions intensity per unit of revenue, because this is the most transparent and comparable indicator.

The Government’s preferred position is to allocate up to around 30 per cent of carbon pollution permits to emissions intensive trade exposed activities, allowing for the potential future inclusion of the agricultural sector.

To provide an indication of how this could work, the Government proposes that activities with an emissions intensity above 2000 tonnes of CO₂ equivalent per million dollars of revenue would have the initial assistance level set around 90 per cent of industry average emissions per unit of output.

We also propose that activities with emissions intensities between about 1,500 and 2,000 tonnes of CO₂ equivalent per million dollars of revenue would have the initial assistance set at around 60 per cent.

The Government also recognises that the rate of assistance to these industries will need to be gradually reduced over time, to ensure that all parts of the economy contribute to the objective of reducing emissions.

To do otherwise would simply place more of the adjustment task on other parts of the economy.

However, I should emphasise the precise thresholds, proposed rates of assistance, the structure of assistance and the preliminary list of activities that would be covered are indicative only. If subsequent information indicated that these parameters would result in an allocation of carbon pollution permits above or below 30 per cent of national emissions, then the Government would need to recalibrate the parameters.

Acting with the rest of the world

Much has been said in recent weeks about the need for Australia to act with the rest

of the world, and not go it alone.

The great irony of this call is it seems to have emanated from those who left Australia truly isolated and out of the Kyoto Protocol for the best part of a decade.

Of course, after so many years of inaction, it is impossible for Australia to be in front of the rest of the world in tackling climate change.

A greater risk is being left behind in a world of emerging economic opportunities.

There are great opportunities in moving to the clean economy of the future – a point that has been made by Professor Garnaut among others.

With so much to gain from tackling climate change, and so much to lose if we don't, we recognise that it is squarely in Australia's self-interest to act.

And we are also helping shape a global solution on climate change. We are heavily engaged in the next phase of international negotiations.

It doesn't take close study of these negotiations to know that if we are going to get the global action we need, we will have to act at home.

Leadership from the developed world encourages other countries to join the global effort.

With the Carbon Pollution Reduction Scheme, Australia will join other developed nations in the fight to reduce carbon pollution. Emissions trading is already operating in 27 European countries. Twenty-eight states and provinces in the US and Canada are introducing emissions trading, as is New Zealand. Japan is considering introducing a scheme. And in the US, both Presidential candidates are committed to introducing schemes to reduce carbon pollution.

The Government will take careful account of the evolving state of international negotiations in determining the path we set to meet our target of reducing Australia's carbon pollution by 60 per cent below 2000 levels by 2050.

We will do this when we announce our medium term target range later this year, and in 2010 when we set the final path to 2015 and the indicative paths to 2025.

The design of our scheme is aimed at establishing a robust and credible market that provides the right degree of certainty for the market to plan and invest in the low emissions technology we need, while still providing flexibility to adjust to the global context.

Conclusion

Climate change is sometimes seen as a distant and abstract problem.

But, in fact, it is a problem we face here and now.

The world's climate is already changing.

The evidence shows that Australia's climate is particularly vulnerable.

The longer we delay action, the harder it will be and the more it will cost.

Our test of responsibility lies in what we do today, because what we do today will determine whether we are prepared for tomorrow.

This is going to be hard.

This generation is being called to solve a problem which has been many generations in the making. And we are called to act to protect the inheritance of future generations.

We need to move to the clean economy of the future in an economically responsible way, with the minimum possible disruption and at the lowest possible cost to families and business.

We can't afford to wait.

The challenge is great.

But through our history this nation has shown we are a resourceful people, we are an innovative people, we are a capable people.

This is not beyond us.

This is the crucial test of this generation's economic leadership – a test this Government, and the broader Australian community, is determined to pass.