1. International climate policy

A comprehensive binding international climate agreement would clearly be the best way to bring about deep reductions in global emissions. However, right now this is probably best seen as a medium to long term prospect. Neither the United States nor China are currently prepared to make binding commitments.

But there is good reason for optimism about what can be achieved even without a binding international agreement. All major countries have made pledges under the Copenhagen Accord to restrain or reduce their emissions by 2020. It is a bottom-up approach of nationally defined actions and targets.

And most governments so far are standing by their pledges. We heard this from colleagues from around the Asia-Pacific region at a conference right here in this room, just four weeks ago.

The Copenhagen Accord

The Copenhagen targets probably fall short of a 2 degree trajectory, but they do imply significant ambition and effort for most major countries. In particular, the pledges from developing countries that easily exceed what might have been seen as possible just 2 or 3 years ago.

I recently released an analysis that puts the Copenhagen targets by the major countries on a common footing, and compares them across the metrics chosen by the different countries. (It is available on the website of the Centre for Climate Economics & Policy).

The headline results are that (1) the targets by most of the major countries are comparable in their ambition in important metrics, and (2) that developing countries’ pledges can be considered adequate in the context of what rich countries have pledged.

Specifically,
• Targeted changes in absolute emissions differ greatly between countries, broadly in line with economic growth trajectories. The pledges by some non-Annex B countries imply that they would reduce their emissions between 2005 and 2020.

• In per capita terms, the targeted reductions are similar between high-emitting countries like the United States, Canada and Australia, and mid-level emitters like the EU, Japan, South Korea, Mexico, South Africa, Brazil, and Indonesia.

• In terms of emissions intensity (t CO2/$ of GDP), the targeted reductions for most countries are in a very narrow band. China’s commitment to reduce emissions intensity by 40-45% is practically the same as the reductions implied by the targets of the US, EU, Japan, Australia (assuming a 15% target).

• Relative to a hypothetical business-as-usual scenario, the targets of most countries imply a significant reduction – importantly, China’s target will require strong policy effort.

The need for mutual reassurance

The Copenhagen targets are not legally binding. That probably helped make it possible in the first place for developing countries to make ambitious pledges.

Countries will need reassurance that they are not alone in their efforts, that other countries take comparable action. Developing countries in particular will find it much easier to embark on the necessary reforms if the rich world shows that it is possible to de-carbonize without stifling economic growth.

So the name of the game now is for countries to go ahead in implementing domestic policies to cut or restrain emissions, and thereby to encourage others to do likewise.

Getting the Copenhagen Accord more formally recognized under the UN would help. It would give the pledges greater standing, and it would make it easier to apply consistent monitoring and reporting to all major countries.

What does it mean for Australia’s target?

My analysis – and that of others – indicates that the headline conditions for a target ‘up to 15%’ are fulfilled: “major developing countries commit to substantially restrain emissions and advanced economies take on commitments comparable to Australia’s”.

We may see progress on the additional conditions that Minister Combet mentioned, but such progress may be slow and it may be patchy. There is a case for deciding the target soon.

The Minister’s point about a 5% target being demanding is well taken. The fact that a 5% reduction relative to 2000 implies a reduction of 20% or more relative to a business-as-usual scenario is still not widely understood.

Yet for Australia to be seen to contribute our its fair share to the global effort, a
target in the vicinity of 15% is probably necessary.

The fact that we are a high-carbon economy calls for more ambitious reductions. And given our high population growth, a given absolute reduction does indeed mean a greater reduction in per capita emissions. But our very high levels of per capita emissions mean that fast rates of reductions in per capita emissions are needed.

**Investment in mitigation in developing countries**

Let me echo a point in Mr Combet’s speech: as a small and open economy, Australian action is embedded in international action.

The cost-effective way for Australia to achieve a reduction target is to both cut emissions at home, and to invest in mitigation overseas. In developing countries, mitigation opportunities are plentiful but capital is scarce.

Indonesia provides a good example: Geothermal energy is viable in preference to coal fired electricity with only small carbon payments, and there are massive opportunities to cut emissions from deforestation and from peat fires.

There is a common misperception in the public debate to be overcome here. It is not about sending money abroad to buy pieces of paper that say “emissions permit”, and allow us to avoid making changes in Australia. Rather, it is about facilitating investments in other countries that have a global return in the form of lower emissions.

Under the bottom-up framework that right now defines global climate policy, regional alliances for climate policy could become increasingly attractive. It would make sense for Australia and other developed countries in the Asia-Pacific to team up, and help developing countries in the region make low-carbon investments.

**2. Domestic climate policy**

Irrespective of whether and when a decision on Australia’s 2020 target is taken, it is crucial now to put in place a domestic policy framework that starts turning Australia’s emissions trajectory around.

**Carbon pricing**

To the expert and policy community is united in the view that we need a price on carbon emissions. There are disagreements among the economists fraternity, but they concern the choice of pricing instrument and the details of design, not the fundamental notion that we need carbon pricing.

In my analysis, a suitable option in the current circumstances is a so-called fixed price permit scheme. This has elements of both emissions trading and carbon tax. Government sells permits to domestic emitters at a set price that increases from year to year. The system can be readily converted to a market-based trading scheme once the conditions are right for it.
But there are of course other ways of pricing carbon. Whichever is chosen, it is important to (1) create a solid expectation of future carbon prices, and (2) to put the revenue stream that is being created to good use: money will be needed to help with structural adjustment, to support low-income households, to invest in R&D, and to invest in developing countries.

How to put this into practice? A lot is being done now at the leadership level to help achieve a political compromise – the climate change Committee, the business and NGO roundtables, and the update of the Garnaut Review. And the Prime Minister’s commitment yesterday to bring the carbon pricing decision forward to 2011 sends a strong signal about the government’s resolve.

Yet it is also clear that a better effort needs to be made to bring the community along. Carolyn Hendriks will talk about that aspect in just a minute.

3. The long view: economic transformation

In all of this it is imperative to keep the long term objectives firmly in mind.

For Australia, the number one objective is ambitious global mitigation, in order to limit the risk of truly awful climate change impacts.

The other fundamental objective is for Australia’s economy to be successful in a world of deep carbon reductions. That means economic transformation in some key sectors.

Coal

The standout issue is coal, the most carbon intensive energy source. Coal supplies 40% of Australia’s total energy demand, and it is now the largest single source of Australia’s export revenue. Coal exports spiked at around 5% of GDP in 2008/09 when prices were at their peak, and capacity is being expanded.

But prices will come down, and it is far from assured that export quantities will keep rising in the long term. Under scenarios of strong mitigation, global coal use would fall, even if carbon capture and storage becomes commercially viable.

[Slide: IEA scenarios]

Economic transformation

Australia has gone through major episodes of transformation before. For example, until the early 1970s wool exports accounted for a similar share of GDP as coal does now. They are now just a fraction of that.

[Slide: coal and wool exports]

Adjustment was necessary in those rural industries, and there would have been pain. But the Australian economy now is much stronger than it was then. Other industries have taken the labour and capital once dedicated to wool production. Reforms that
opened trade and that made the domestic economy more flexible were crucial to that success.

A similar story could emerge within Australia’s energy industries. Australia is not just a place where fossil fuels are plentiful, but also where opportunities for renewable energy generation are without practical limit. Australia may remain an energy powerhouse even in a low-carbon world.

The shift away from coal will cause adjustment pressures, and helping affected communities through transformation is an important role for government.

**Wrapping up**

The lesson from previous economic transformations is that we need to embrace change, not resist it. Most of the time, making the change is not nearly as hard as it appears beforehand. The costs to existing economic activities are concentrated and highly visible, while the benefits in terms of new economic activities are hidden from view until they eventuate.

And the more resolutely we act at home, the more we will encourage other countries to do likewise.

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Figure 6.1 • World primary coal* demand by scenario

Exports as share of GDP, Australia