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THE COALITION'S DIRECT ACTION PLAN ON ENVIRONMENT AND CLIMATE CHANGE
Incentives for Action

SPEECH TO THE AUSTRALIAN NATIONAL UNIVERSITY CRAWFORD SCHOOL OF PUBLIC POLICY

18 APRIL 2013
CANBERRA

Introduction

It is a great pleasure to be here at the ANU today.

In the run up to what will be a critical Federal Election on September 14, I thought it would be useful to bring together our work on how the Coalition's Direct Action Plan on the Environment and Climate Change will work.

In doing this I want to set out the real international context, the problems with the Carbon Tax and the operation of our Emissions Reduction Fund.

Let me begin with three simple statements. We agree on the science of climate change, we agree on the targets to reduce emissions and we agree on using markets as the best mechanism.

But we disagree fundamentally on the Carbon Tax.

That is because at its heart it is an electricity tax. And because electricity is an essential service, it is not merely a tax on big business, it is a tax on families, pensioners and economic activity. And that is why, in an international environment with no genuinely comparable system, the Government's own modelling shows our emissions will go up not down.

It is also why, rather than trying to double the price of electricity to punitively try and change behaviour, I passionately believe that a buyback, just like a water buyback, is the simplest most effective way to actually reduce emissions.

Our policy is about carrots not sticks.

1. The Global Climate Challenge: China, India, the US and the EU

Let me begin this discussion by looking internationally, as context is critical for our system.

Climate change **is** a global problem. We therefore have to view our actions in terms of global solutions and global trends.

According to the 3rd Garnaut Paper, **between 2005 and 2020 Chinese emissions will increase from approximately 5 billion tonnes of CO2 per annum to over 12 billion tonnes of CO2** per annum[1] as hundreds of millions emerge from poverty – and as China increasingly manufactures for the rest of the world.

One reason for this unprecedented increase, therefore, is the massive growth in production of steel and aluminium, as production shifts from Australia and many other countries to China.

[1] Garnaut Climate Change Review – Update Paper 3, "Global Emissions Trends," 11 February 2011, p. 29.

If, then, **we design our domestic programs in a vacuum, there is the risk of unintended consequences** such as:

- Leakage of manufacturing to countries with higher emissions profiles; and
- Loss of Australian jobs and investment.

1.1 International Realities

The starting point, then, for any international assessment is the finding of the Productivity Commission that:

> "no country currently imposes an economy wide tax on greenhouse emissions or has in place an economy-wide ETS[2]."

Not China, not India, not the USA, not even the EU.

China and India

In spite of the Commission's findings, the Prime Minister has at times tried to highlight that China is closing some of its smaller coal fired power stations. That's true. The missing part of the sentence though should have been "and replacing them with larger stations as part of the fastest growth in emissions and coal consumption in human history."

Let me take the example of Xilin Gol, which is just one of 12 prefectures within Inner Mongolia which is itself one of 33 provinces across China.

The China Daily reported that during the 12th Five Year plan from 2011-2015, this one prefecture of just over a million people:

> "Plans to build 24 large scale coal mines and eight clusters of coal-fired power plants[3]."

It is not surprising, then, that Chinese coal consumption will increase from 1.4 billion tonnes in 2002 to approximately 4 billion tonnes in 2015. And only last year, Minister Wu Yin indicated that Chinese coal consumption would continue to grow to 7.5 billion tonnes a year by 2030.

Similarly, Indian emissions are also growing at a dramatic pace. India now accounts for approximately 5% of global emissions and this figure is rising commensurately with its economic growth. Projecting forward, the ANU's own Frank Jotzo has suggested that Indian emissions from fuel combustion alone will rise by between 75% and 94% from 2005 to 2020.

Unfortunately, the Prime Minister has also attempted to distort what is happening in India with the statement that India is already taking "national action" on pricing carbon through a "clean energy tax on coal." The Indian coal tax is $1 per tonne. By comparison the State royalty on Queensland coking coal is $20 per tonne right here in Australia.

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[2] *Carbon Emission Policies in Key Economies*, Productivity Commission Research Report, May 2011, p. 50.
[3] *China Daily*, "China's Xilin Gol League plans power boost", 20 October 2010.

China is taking steps to reduce its emissions intensity, overwhelmingly through clean air and energy efficiency standards. And this should be welcomed. As to the possibility of any type of future trading scheme, we will judge anything as and when it may come into being, but my view is that the Productivity Commission will still be right about there being no comparable system and impost to that in Australia.

The United States, Canada, Japan and South Korea

Turning from India and China (which is already the largest greenhouse emitter in the world) to the United States, there is virtually no prospect that the US will adopt a Cap and Trade system at any point in the period to 2020.

Senior Republicans such as Jim Sensenbrenner have declared that: "Any kind of carbon tax is dead in the US[4]." Moreover, on three occasions post election the White House has ruled out a carbon tax and the President used his 2013 State of the Union address to acknowledge that the most likely course of action is energy efficiency programs.

In short, **higher energy and electricity taxes are off the national agenda in the United States. Instead, the United States has gone down a different path of directly supporting technology,** including through various forms of incentives for activity.

Just like the United States, carbon taxes are off the table in Canada and Japan where they have been either resoundingly rejected or deferred indefinitely. In the case of Canada, government in part changed on the issue and in Japan the deferral is now indefinite. In South Korea, any possible scheme is so light in its actual reach that it cannot remotely be compared with the $9 billion a year tax in Australia.

This brings me to the European Union.

European Union

Nowhere is the reality of what is actually happening more starkly obvious than in a proper comparison of the Australian Government's Carbon Tax and what the European Union is actually doing.

The Minerals Council of Australia has released research showing that over the first 5 years of the European Emissions Trading Scheme, it raised approximately $500 million per year.

The Australian Carbon Tax by comparison will raise approximately $9 billion per year. **The Australian Carbon Tax will be 18 times larger in dollar terms than the European scheme in each of its first five years**.

However, when you take into account population, the comparison is devastating. The EU has a population of just over 500 million. Therefore the EU scheme raised just over $1 per person per year.

[4] Greg Sheridan, "More sense from Sensenbrenner than from Garnaut," *The Australian*, 30 June 2011, p. 16.

Australia has a population of approximately 23 million, so our scheme, at the Government's $23 price, is raising almost $400 per person per year, making it 400 times more onerous per capita than the European scheme.

Even in the last 48 hours we have seen European carbon prices plunge by up to 45% before settling close to 30% down. The European system to which the Government has tied Australia's electricity prices is now deeply unstable.

MEPs voted in Strasbourg just two days ago to reject a proposal from the European Commission to delay auctioning of carbon allowances in the European Union's emissions trading scheme (ETS).

As a result, Stig Schjølset, head of EU carbon analysis for PointCarbon, predicts that:

> **"The EU ETS will not bring about any additional greenhouse gas reductions, so it will be irrelevant in terms of reducing total emissions in Europe."**

Two simple messages come out of this.

First, the Australian Carbon Tax is now 550% higher than the European scheme. It is also broader. It means the Australian tax is completely out of line with the rest of the world.

Second, Treasury's own modelling shows that the Australian tax is set to soar to $37 per tonne by 2020. Either the Government's modelling is correct and we will be even more out of line with the rest of the world, or it is not, in which case the ALP will face a multi-billion dollar Budget black hole and the deficit will only get worse.

Just to complete the picture, New Zealand has an actual cost of just over $1 Australian per tonne. The ALP's Carbon Tax is therefore 20 times more expensive than the system adopted by our Kiwi neighbours.

So when we look honestly at the international system a number of conclusions can be drawn:

- China's emissions growth of 5-12 billion tonnes from 2005 to 2020 is the most important fact in understanding global emissions;
- The United States, Canada and Japan have all either ditched or deferred carbon tax systems and anything that may happen in Korea will overwhelmingly involve free permits; and
- The Australian Carbon Tax is roughly 18 times larger than the entire EU system in its first 5 years and almost 400 times more expensive on a per capita basis.

These facts are the real reason a push for a single global tax is failing. They will not be affected by any change in Australia. **The rest of the world has overwhelmingly rejected the Australian model of a deep punitive electricity and energy tax**.

1.2 Rethinking Global Approaches to Climate Change: G20 and Sectoral Approaches

The sheer magnitude of the global numbers makes it clear that solutions have to come at the international level. It also makes it clear that **the problem of leakage will simply destroy the effects of poorly designed unilateral action by sending jobs and emissions offshore.**

In that situation I believe there are two important steps we should take at the international level.

First, the all-in UN negotiating approach of 180 countries locked in a convention centre with up to 40,000 observers is increasingly ineffective. Need I say any more than Copenhagen.

In the real world, any progress will be between the United States, China, India and the EU.

We should therefore task the G20 with a special responsibility for negotiating a four-way compact between these players. If we can do that then we have a genuine base for a future global agreement. There is still a role for the UN system but the real solution is within the G4 concept.

The second international step is to consider sectoral agreements. What this means is that we are pragmatic. Rather than focussing everything on country targets, we should focus on:

- A common approach for the steel industry;
- A common approach for the cement industry;
- A common approach for the smelting sector and so on.

This sector by sector approach may in fact be a much faster way to genuine emissions reductions because it in part addresses the problem of border inequality and leakage of jobs and emissions off shore.

Yes, we will still look at national targets. But the heart of real progress in my view is for parity of action across industrial sectors.

Against this background, the Government wilfully fails to recognise the global reality. The Carbon Tax has been **crafted against a fabricated and imaginary international environment** and will therefore simply send jobs and emissions offshore while driving up costs for families and pensioners.

2. Labor's Carbon Tax: Doesn't Work, Hurts Families and Sends Jobs and Emissions Offshore

In such an international environment there are three fundamental criticisms of the Australian Carbon Tax:

- It doesn't work, with Treasury's own figures showing our emissions set to rise from 560 to 637 million tonnes between 2010 and 2020.

- It hurts families and will send jobs offshore as the tax rises continuously to $350 per tonne by 2050 according to the Government.
- And it will lead to expenditure of $3.7 billion a year on top of the tax for purchasing foreign carbon credits by 2020.

2.1 Why the tax doesn't work

The starting point for understanding the Carbon Tax is that Australian emissions will go up from 560 to 637 million tonnes between 2010 and 2020. Despite a $9 billion a year tax, our emissions go up. And this is the Government's own modelling. So if you want to address climate change, then as an environmental policy it is a failure.

The fatal flaw is that the Carbon Tax is first and foremost **a tax on electricity.** Given that we do not import electricity, just as we warned, prices have been passed through in every bill to every pensioner, to every family, to every farmer and to every small business owner.

For an average household there has been a 10% increase in electricity costs. For an average manufacturing business, the increase has been 14.5% already.

The Government has tried to claim that these electricity price rises are a good thing and are driving down electricity consumption. However, the facts are different. Electricity is both globally and domestically an essential service. In economic terms that makes it an inelastic good. One recent international study found that electricity consumption is highly inelastic in both the United States and the EU.

The study found that a 10 per cent increase in electricity prices would produce only a 2-2.5 per cent reduction in CO2 emissions from residential electricity consumption. In other words, electricity pricing is a blunt and inefficient mechanism for changing household energy-use behaviour.[5]

In Australia, the NSW Independent Regulator recently found that a 50 per cent price rise over 5 years from 2005-2009 inclusive resulted in only a 6 per cent decrease in electricity consumption per capita[6]. More recently, the Australian Energy Market Operator found that just one-sixth of the change in Australian energy market consumption was linked to massive price rises with the vast bulk of the drop in energy demand due to the drop in overseas demand for our goods since late 2008.

The one area where there **is** an effect from electricity prices however, is in internationally-exposed manufacturing. Companies such as Boral, Penrice and Amcor have all cited higher energy prices as a reason for dropping Australian jobs. In Penrice's case, instead of producing

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[5] Ines M. Lima Azevedo, M. Granger Morgan and Lester Lave, *The Electricity Journal,* Jan/Feb 2011, Vol 24, Issue 1.

[6] *Residential Energy and Water use in Sydney, the Blue Mountains and Illawarra - Results from the 2010 Household Survey* Electricity, Gas and Water — Research Report, December 2010, p 39.

in Australia they will simply import from the United States, potentially increasing global emissions as a perverse effect.

2.2 The Cost to Families

While the cost to families begins with electricity, it falls into a number of categories.

First, the average starting cost per household will be $515 in the first year alone. This is **of itself a huge impost on families and pensioners and farmers** struggling with electricity stress. And there is **no guarantee that it will not be massively higher for any one pensioner or family or farmer**.

Second, the **tax is designed to increase permanently. It will increase to** $350 a tonne by 2050 according to the Government's own modelling.

2.3 The hidden secret: $3.7 billon a year in foreign carbon credits

Apart from the massive $9 billion a year cost of the tax, the central flaw is that it doesn't do its job. Australia's domestic emissions are set to go up not down.

As a consequence, late last year the Government quietly released modelling that showed we would have to purchase 100 million tonnes a year of foreign carbon credits to meet our targets.

Given that the Government's modelling indicates that the price in 2020 will be $37 a tonne, this is an annual purchase of approximately $3.7 billion of international permits in 2020 alone. And this is in **addition to the Carbon Tax.**

3.Direct Action: Simplicity and Incentives.

One of the tests of policy is credibility in action. The current government was responsible for the pink batts tragedy, the green loans program, the Cash for Clunkers proposal and the Citizen's Assembly proposal.

The Coalition, however, was responsible for creating Kakadu National Park, bringing an end to whaling in Australia, putting the Great Barrier Reef on a sustainable footing and establishing the Natural Heritage Trust. And we intend to continue that line of positive environmental action by implementing our Direct Action plan.

In contrast to the complex, punitive, money churn that is the Carbon Tax, the Coalition's Direct Action Plan is based on two clear principles: simplicity and incentive.

We will reward people for reducing emissions, not make it harder for them to do business. We will use the classic market mechanism of a reverse auction. Contrary to an electricity tax, this is a perfectly conventional mechanism to find the lowest cost way to reduce something or have services provided. In particular, unlike the multiple changes in the Government's plans over the last three-and-a-half years, our plan remains stable and consistent.

The Coalition's Direct Action Plan will ensure Australia reaches its target of a five per cent reduction in emissions by 2020.

It is a simple, practical approach, which will not only address climate change, but improve our environment. Its key benefits are:

- It doesn't hurt families and businesses with a $9 billion a year electricity tax
- It will mean cheaper electricity and gas prices
- It is good for business as it rewards those who do the right thing and reduce their emissions
- It will keep Australia competitive by taking away the Carbon Tax, which makes local businesses and jobs less competitive internationally
- It is based on sound financial management, using a market mechanism to deliver the lowest cost methods of reducing emissions in Australia
- It will meet our commitment on addressing climate change
- It reduces emissions here in Australia, while a Carbon Tax will see our emissions rise from 560 million to 637 million tonnes by 2020, forcing businesses to buy emissions reductions from overseas to make up the shortfall

3.1 How does it work?

Direct Action provides incentives to those who reduce CO2 emissions so we can reach our five per cent reduction target by 2020.

While it encompasses programs to support the uptake of solar energy and revegetation of our land, at its heart is an Emissions Reduction Fund to directly support CO2 emissions-reduction activities – also called abatement.

Abatement will be purchased via a market mechanism to achieve the lowest price. You could call it a carbon buy-back. It is similar to how the international Clean Development Mechanism operates.

We will use a reverse auction to buy the lowest cost per tonne abatement. Contrary to what the ALP says, we are source neutral. The lowest cost abatement may be a mix of energy efficiency, cleaning up waste coal mine gas, cleaning up power stations and landfill gas. It may be reafforestation of marginal lands or revegetation or improvement of soil carbon.

In economic terms, we will simply hold a reverse auction and buy up the cost curve. In layman's terms we will buy back abatement. Whereas the Carbon Tax tries to drive up the price of basic services in order to force down use, with a massive deadweight loss, we will not provide a dollar unless there is an actual reduction of emissions. Just like a contract for wheat, we only pay on delivery of actual abatement.

This system is also the structure by which the Government buys back water in the water market. It is the preferred option because it is a voluntary market, into which people choose to sell water, and allows the Government to minimise its cost while achieving the environmental benefit of additional water flows. The alternative would be to double the price of water in an attempt to reduce usage. But everyone agrees that targeted action is far more effective.

The Government has also proposed a very similar structure for its $250 million Non-Kyoto Carbon Fund. It issued a discussion paper late last year which outlines a scheme to purchase abatement through a reverse auction, though you won't hear any Government Minister ever talking about it.

Let me just take the audience through this. Of all the systems in the world, the Government has designed an abatement purchasing scheme using a reverse auction for land sector emissions reduction. This is exactly - and I mean exactly - the system they demonise while quietly developing one themselves.

3.2 Capped budget

In just the same way that the ALP's Non-Kyoto fund has a capped budget, so does the Emissions Reduction Fund. When we designed the fund, we consciously set a capped budget, ensuring sound financial management with no budget blow-outs.

The Emissions Reduction Fund will have an initial allocation of $300 million, $500 million and $750 million over the forward estimates period. This compares with the Carbon Tax of $27 billion over the same period.

Decisions on allocation will be made through a reverse auction starting with the lowest priced abatement.

More importantly, the funds will only be allocated when there is a direct reduction in emissions. In short it is a contract for delivery.

What, then, are the supporting mechanisms to implement the fund?

3.3 Supporting Mechanisms

We will immediately move to abolish the Carbon Tax and hope to have this removed within six months if we are elected. In reality, we expect and will urge the ALP to accept the clear mandate of a new Government and not block the legislation in the Senate. In the same way, the Coalition accepted the mandate of Labor and did not oppose the repeal of Workchoices.

If elected, we will also abolish the Climate Change Commission, the Climate Change Authority, the Clean Energy Finance Corporation and the Energy Security Fund and bring the relevant functions in house, under a merged Climate Change and Environment Department.

The conservative figure for savings from abolishing the business subsidies associated with the Carbon Tax is $20 billion over four years.

The Emissions Reduction Fund will operate using existing architecture originally created or proposed by the Coalition. That is, we will simply adapt three existing programs and mechanisms.

First, the Carbon Farming Initiative, which was initially proposed by the Coalition, will be expanded to include a wider range of emissions reduction methodologies. We will support the application of methodologies that have been approved internationally, modifying for local conditions where required.

The current system of methodology approvals has restricted people from engaging in potential projects, both in terms of time and scope.

Second, the Clean Energy Regulator, which succeeded the Office of Renewable Energy Regulator created by the Coalition Government, will be responsible for approving the methodologies. It will ensure that the emissions reduction being claimed is genuine and verifiable. We will only pay for real abatement once it is delivered. There will be the certainty of a contract for proponents coupled with the safety of payment on delivery for the Government.

While long-term contracts for abatement will be available to assist organisations to secure finance to undertake projects, the payment will only occur on delivery. At present, the Clean Energy Regulator approves the viability of projects and issues recognition of abatement once it occurs. This method will continue. Methodologies that have been approved to date will be maintained. Registered projects will also be continued. The difference is that we will unblock the approvals process, create a 25-year option for land-based sequestration and broaden the range of methodologies to include all forms of abatement such as cleaning up power stations and energy efficiency.

Third, we will continue to use the existing National Greenhouse and Energy Reporting Scheme (NGERS) – which was created by the former Coalition Government - as the key reporting system for Australia's emissions. Our aim is to make it the single national reporting scheme, cutting red tape and the requirement to duplicate reporting to both Federal and State Governments.

3.4 Market Structure

In order to exclude unintended impacts, if elected we will hold a White Paper process after the election. It will provide an opportunity for industry to make submissions on issues such as the timing of the auction process and the setting of baselines. We will call for submissions within 30 days of being elected, consult between days 60 and 100, release the White Paper and draft legislation by day 100, receive further feedback and release final legislation by day 150. Our goal is to commence the system on 1 July 2014.

However, we have already held extensive discussions with all sectors to encourage potential participants to consider how they can engage with Direct Action and create opportunities for generating abatement, so they are fully prepared for its implementation. We are also keen for any suggestions or feedback at this stage, to ensure all potential issues are addressed. Throughout, we are being transparent and open about our policy, providing as much clarity and certainty as possible, keeping in mind that the structure of our scheme remains unchanged since it was announced three years ago.

The reverse auction is the opposite of picking winners. It automatically orders the most cost-effective forms of emissions reduction from the various proposals that the market would produce. It is in fact a classic market mechanism used by this very Government for buying water, biodiversity outcomes and even emissions under the Non-Kyoto Carbon Fund

A separate organisation would conduct the auction, independent of the Clean Energy Regulator and the verification process. We would be keen to use a current agency, such as Low Carbon Australia, to make the transition as simple as possible. The water market also has a similar division of roles to avoid a potential conflict of interest between verification and purchasing.

There will be an opportunity for organisations to act as aggregators and bid into the market as a group. As an example, an electricity retailer may work to aggregate emissions reduction achieved through energy efficiency by its customers. Farmers may work together to deliver carbon capture and storage in soil, or landowners to achieve abatement through revegetation or reafforestation of marginal lands.

One of the questions I am often asked is where will the abatement come from. The answer is that whether it is from cleaning up power stations, from waste coal mine gas, from landfill

clean ups, the land sector or energy efficiency, it will be the lowest cost. On balance, it is likely to be a range of the above activities with none dominating but with energy efficiency and the land sector being early adopters.

Indeed, since we issued the Direct Action Plan in 2010, the only change is that the likely supply of abatement has grown since our original projections and the likely cost of the abatement has dropped, although our funding allocations remain the same.

In short, even the Government has quietly recognised the power for reverse auctions, whether it is for water or carbon.

Conclusion

Ultimately, the Coalition is committed to reducing Australia's emissions by 5 per cent by 2020 and to the bi-partisan conditions for any further reduction. It is a commitment we make in acknowledgement of the need for all countries to work together on what is a major global issue.

Our Direct Action Plan is a simple, low touch market mechanism. The Emissions Reduction Fund will not only reduce our emissions, it will improve Australia's environment through a range of measures including revegetation, better land management and enhanced soil quality. However we will always select the lowest cost abatement, whether it is in the land sector, the waste sector, the resources sector, the power sector or through actions such as energy efficiency.

Unlike the Carbon Tax, Direct Action does not make it harder for businesses to operate. We are assuming no revenue from the system.

Rather than a tax that doesn't reduce emissions but does increase costs, and which leads to $57 billion in foreign carbon credits being purchased each year by 2050, we will focus on incentives.

The Coalition will instead reward innovation and initiative, supporting projects that deliver real emissions reductions right here in Australia. And we will do this by using the market to find the lowest-cost abatement.

This simple, straightforward approach is a vastly better way to tackle climate change than the blunt instrument that is the Carbon Tax, which has already inflicted economy-wide pain and will continue to do so as it climbs to its own predicted price of $350 per tonne of CO2 by 2050. That is why we will repeal the Carbon Tax and replace it with a classic reverse auction system, based on incentive and innovation.