THE HON GREG COMBET AM MP
MINISTER FOR CLIMATE CHANGE AND ENERGY EFFICIENCY
MINISTER FOR INDUSTRY AND INNOVATION

THE ROLE OF MARKETS IN TACKLING CLIMATE CHANGE

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CHECK AGAINST DELIVERY

Introduction

Thank you for the opportunity to speak at this investment conference.

What do fund managers, bankers, financiers, analysts and investors have to do with climate change?

Everything.

Climate change is a classic example of how we can harness the power of markets, and investment markets in particular, to reduce risks, underwrite economic prosperity and deliver social welfare.

Climate change is the most serious environmental problem the world faces today.

Left unchecked, it will impose significant economic, environmental, social and human costs on future generations.

The scientific advice is clear: to tackle climate change, the world needs to reduce the amount of carbon dioxide and other greenhouse gases we release into the atmosphere.

In turn, this requires the world to invest in cleaner ways of producing the goods and services of modern economies:

- We need to adopt cleaner sources of energy.
- We need to use energy more efficiently in our factories, offices and homes.
- And we need to commercialise the innovative clean technologies and production processes that will decouple economic growth from growth in carbon pollution.

The investment community has a large part to play in bringing about these changes.

So does government.

Indeed government policies to tackle climate change will be central to the investment decisions you and your clients make in coming years.

That is why it is important to understand that there are two sharply different policy approaches on offer in Australian politics today for driving the economic transformation needed to tackle climate change.

Under the first approach, the government places a price signal on carbon pollution and allows the choices and investment decisions of individual businesses, investors and consumers – in other words the market – to drive the economic changes needed.

Under the second approach, the government eschews markets, decides which businesses should take which actions to reduce pollution and hands out taxpayer subsidies to finance those actions.

The first approach – according to institutions like the federal Treasury, the Productivity Commission, the OECD and the IMF – is the most efficient and lowest cost way of reducing carbon pollution.

The second approach has been widely criticised as imposing higher costs, delivering less efficient outcomes and offering no certainty that the pollution reductions will even be achieved.

It may seem strange to some, but it is the Labor Party which has implemented the low-cost market-based approach while the Liberal Party wants to scrap this and replace it with the high-cost, anti-market approach of subsidies and central planning.

To help you understand the importance of this policy choice, and its relevance for the investment community, I want to use this speech to do three things.

First, to explain how the Government's carbon price and wider Clean Energy Future package works.

Second, to outline the central role of investment in tackling climate change.

And finally, to make the case for why investors should support the Government's pro-market climate change policies and reject the Opposition's anti-market nostrums.

<u>How the Gillard Government is acting</u>

The scientific advice is that the world faces significant impacts from climate change unless carbon pollution is curtailed.

Governments around the world have agreed to seek to limit the average global temperature rise to less than two degrees Celsius above pre-industrial levels.

The science indicates that stabilising the concentration of greenhouse gases in the atmosphere at 450 parts per million gives a 50/50 chance of not exceeding that temperature goal.

Countries around the world are acting. Ninety countries, accounting for over 80 per cent of global emissions, have committed to reduce or limit emissions by 2020.

And at last year's climate change conference in Durban, the parties to the UN Framework Convention on Climate Change decided to negotiate a new international agreement – this new agreement will impose binding obligations for emissions reductions from 2020.

Importantly the two biggest emitters, the United States and China, agreed to this mandate.

Australia needs to play its part: as a responsible global citizen; as the world's 15th largest emitter; and as the highest per-capita emitter of all developed economies.

We also need to play our part because a new global climate change regime is coming.

If we do not prepare for the imposition of binding obligations to cut emissions from 2020 we will face a significant economic shock and potential trade retaliation.

It is in Australia's economic interests, especially given the importance of our trading relationships in the Asia-Pacific, to deal effectively with this issue.

In fact, it is pivotal to our economic future that we foster investment in clean technologies.

That is why the Gillard Government has designed, legislated and implemented a comprehensive policy package to achieve this transformation: the Clean Energy Future plan.

This plan comprises four key elements:

- a carbon pricing mechanism that will create the incentive for businesses to cut pollution and invest in cleaner energy sources;
- strong support for renewable energy including the $10 billion Clean Energy Finance Corporation which will invest in businesses seeking to get innovative clean energy proposals and technologies off the ground – this support, together with the carbon price and the Renewable Energy Target, will drive $20 billion of investment in renewable energy over the next eight years and $100 billion to 2050;
- measures to encourage energy efficiency in businesses and households, including the $1 billion Clean Technology Investment Programs which is driving investment in energy efficient and low pollution equipment in manufacturing businesses;
- the Carbon Farming Initiative and other measures to promote the storage of carbon on the land through improved agricultural and land management practices.

These policies will ensure Australia meets its bipartisan target of reducing emissions to at least five per cent below 2000 levels by 2020.

Carbon pricing is at the heart of the Government's Clean Energy Future package.

A carbon price effectively means the country’s biggest emitters of greenhouse gases must buy a permit for every tonne of pollution they release into the atmosphere.

This creates a powerful financial incentive for businesses to reduce their emissions. Individual businesses will decide the cheapest way to achieve this.

Carbon pricing will also spur investment in clean energy by making it more competitive with coal-fired electricity generation.

The carbon price will initially apply to around 350 of the nation's biggest polluters – mainly facilities that emit 25,000 tonnes or more of carbon dioxide-equivalent greenhouse gases a year.

With the start of the carbon price, large emitters have a choice: reduce emissions or pay the carbon price.

Where it is cheaper to reduce a tonne of emissions than to buy a carbon permit, businesses will make the reduction.

This not only drives emissions reductions, it ensures they occur at the lowest cost.

For the first three years, the carbon price will be fixed, starting at $23 a tonne in 2012-13.

The three year fixed price period is transitional. It gets Australia on the road to an emissions trading scheme (ETS) where the carbon price is set by the market.

Under the ETS that will start on 1 July 2015, the Government will set a cap on greenhouse gas emissions, and therefore the number of permits that are sold. This cap will be reduced each year, which is how we will meet our emissions reduction targets.

An ETS also enables nations to link their efforts to cut emissions. With linking, a business that is a large emitter in one country can purchase a permit in another, leading to a common carbon price.

The Government has secured agreement to link Australia's ETS with the European Union Emissions Trading System.

This means that from 1 July 2015 Australia's carbon price will be the same as the carbon price in 30 other countries – including Great Britain, Germany and France – and the same as applies to 530 million people.

Linking our ETS with Europe is a historically significant outcome. It is a major step in countries joining together in their efforts to tackle climate change.

In time the Government intends linking with emissions trading schemes in New Zealand and throughout the Asia-Pacific region, with Australia’s largest trading partners.

We are now seeing increasing evidence of the development of carbon markets in key trading partners like Korea and China precisely because it is the least cost way to reduce emissions.

The role of investment

Investors have a central role to play under this policy.

By putting a price signal on the costs of releasing greenhouse gases into the atmosphere, Australia will begin the economic transformation needed to reduce our carbon pollution and maintain our international competitiveness.

The carbon price creates an incentive to reduce pollution and will stimulate investment in low emissions technologies and processes.

A market-based approach is the best way to get an orderly, planned and gradual transition to a low carbon economy, avoiding unnecessary cost and dislocation by sending clear and consistent messages to investors.

The success of the carbon price will be built on Australia’s robust banking and financial sector because it provides the confidence investors need to operate in the market place.

Since 1 July the Australian community has had a chance to experience the reality of carbon pricing.

The wholesale price of electricity in Australia now reflects the price of pollution paid by the largest emitters of carbon pollution in the economy.

This price signal is flowing to all parts of the economy.

It is causing a rethink of how resources are best allocated, particularly in our energy sector.

It has not caused the sky to collapse, whole towns to disappear or prices to rise unimaginably – as some of the more fanciful and deceitful forecasts in the political market place had claimed.

Rather it is causing businesses to start taking action to improve their energy efficiency and lower their emissions.

It is also creating opportunities for the investment and banking sectors to facilitate Australia’s transition to a low carbon economy.

The carbon price is working as intended.

And through the wider Clean Energy Future package the Government is playing a key role in fostering investment in clean technologies.

Over $15 billion is being invested through initiatives like the $10 billion Clean Energy Finance Corporation.

This funding will facilitate increased flows of finance into the clean energy sector, removing barriers to project financing.

It is important for governments to play a role in this process, because a range of factors can inhibit the financing of clean energy projects.

Such factors include global financial conditions, the complex nature of Australia's electricity markets, the cost of renewable energy and the preference of investment institutions for listed assets.

Alongside the Government's central role in laying the policy foundations, is a key role for the private sector, particularly the banking and financial services sectors.

The Clean Energy Finance Corporation is designed to work alongside the carbon price and Renewable Energy Target to help mobilise private investment in renewable energy and low-emissions and energy efficiency technologies. It will also invest in manufacturing businesses that provide inputs to the clean energy sector.

Private sector expertise will be fundamental in the investment selection processes of the Clean Energy Finance Corporation.

Importantly, because the Corporation has a public policy purpose, it has different financial risk/return requirements and values any positive externalities from investments.

That is, for a given financial return, the Corporation may take on higher risk and, for a given level of risk, due to positive externalities, may accept a lower financial return.

As a result of the Clean Energy Future package and carbon pricing, billions of dollars of investments are flowing to clean energy capital, making this one of the most important industry, innovation and investment policies Australia has seen.

Examples of these investments include the following:

- Industry Funds Management is the owner of Pacific Hydro.
- VicSuper has invested $30 million in the Cleantech Australia Fund.
- And the Retail Employees Super Fund (REST) is a direct investor in the Collgar Wind Farm in Western Australia's wheat belt.

More than $5.2 billion was invested in renewable energy in 2010–11.

This scale of investment is driving the economic modernisation of Australia.

It is setting us up to be internationally competitive in a 21st century where the world will be reducing carbon emissions.

The policy choice

I started this speech by outlining the policy choice Australia faces on tackling climate change.

I have explained how the Government's policy delivers certainty on Australia's emissions reductions by putting a cap on emissions from entities covered by the carbon price.

Our policy also achieves these emissions reductions at the lowest cost because it is a market mechanism.

It gives business and the investment community the price signals and certainty needed to stimulate the transformation of our economy to a low pollution future.

And it allows Australia to link its efforts to those of our trading partners, ensuring our economy can take advantage of low-cost carbon abatement options internationally.

What is the policy alternative?

The Coalition is promising to deliver the same emissions reductions as the Government by 2020.

But under Tony Abbott it is offering a radically different policy for achieving these reductions.

Mr Abbott not only talks up scrapping the carbon price.

He also wants to bar the use of international carbon markets for meeting Australia's emissions reduction targets, an irrational stance which Treasury estimates will double the cost to the Australian economy of reducing emissions.

And he wants to replace the market mechanism of a carbon price with a taxpayer-funded grant scheme which would "buy" emissions reductions from emitters.

The cost of emissions reductions under a government-administered grants program would be much higher than under a market mechanism.

A market mechanism uses normal market forces to ensure the cheapest abatement opportunities are pursued first.

By contrast, a taxpayer funded grant scheme administered by politicians and public servants would likely end up pursuing higher cost abatement.

One of the Coalition's schemes, for instance, would spend $1 billion of taxpayer funds putting solar panels on household roofs.

Supporting solar panels is helpful for householders but it is one of the most expensive ways of reducing greenhouse gas emissions.

A study by the Productivity Commission last year put the cost at around $400 for every tonne of carbon pollution abated through rooftop solar panels – compare that to a carbon price from this July of $23 a tonne.

Another one of Mr Abbott's schemes is to plant trees to absorb carbon.

Again, planting trees is an attractive-sounding idea – but to meet the bipartisan 2020 pollution reduction target you would need to plant trees on an area of land greater than Australia's entire croplands and similar in size to the entire land area of Victoria and Tasmania combined.

A study by the Grattan Institute last year estimated that under a grants scheme, government would need to spend $100 billion to meet the 2020 emissions reduction target.

In summary, Mr Abbott's approach is anti-market, high-cost, fraught with risk, and cannot deliver its own emissions reduction target.

That is why I make the case that the Coalition should not, cannot and will not repeal the carbon price.

Mr Abbott's threat to repeal the carbon price is reckless and should be of concern to the investment community.

Repeal would be the epitome of sovereign risk.

It would remove any prospect of meeting our international emissions reduction targets and say to the world that the highest per capita emitter in the developed world does not take climate change seriously.

It would significantly diminish Australia’s international standing with the international investment community and community of nations.

Since carbon pricing has been legislated, electricity markets and liable entities have been pricing carbon into investment decisions, operational decisions and forward prices.

We are already seeing electricity generation becoming less pollution-intensive.

Australian Energy Market Operator statistics show the emissions intensity of electricity generated for the National Electricity Market has fallen since the carbon price started on 1 July this year.

The AEMO figures show that in the first three months of the carbon price, electricity generated for the National Electricity Market emitted 0.85 tonnes of carbon pollution for each megawatt hour - a 7.6 per cent decline in emissions intensity compared to 2011-12.

This means the amount of carbon pollution released into the atmosphere in the September quarter this year was 2.4 million tonnes lower than it would have been if emissions intensity had remained at the 2011-12 level of 0.92 tonnes per megawatt hour.

Forward prices are being locked into contractual arrangements and regulatory determinations.

Businesses and investors are making decisions based on the carbon price.

Repealing the carbon price would be damaging to investment confidence and undermine the business decisions which have already been taken.

This would see financial markets increasing the risk premiums for investments in Australia.

Australia would pay more while turning its back on investment in a clean energy future.

The cost of the risk premium would be felt in electricity prices without any environmental benefit.

Mr Abbott's threats of repeal are economically reckless, destructive to the national interest, and ultimately futile.

It is akin to a populist Liberal Party leader in the 1990s threatening to repeal the economic reforms of the Hawke and Keating Governments – to fix the exchange rate, increase tariffs and re-regulate the financial system.

They would have been cast, quite rightly, as a crank and a reactionary.

Mr Abbott's position on carbon pricing and climate change is out of step with mainstream economists, scientists and the modern reform tradition embraced by both major Australian parties.

It is out of step with the Liberal Party's philosophy and history.

Every living Liberal leader has supported carbon pricing – including even Mr Abbott himself in the past.

Ultimately his position is not driven by genuine policy and national interest considerations – it is purely driven by politics.

Conclusion

Carbon pricing is the next wave of economic reform in what has been a long tradition of reform in this country.

Just as Hawke and Keating's reforms – including the crucial reforms in the banking and finance sector – laid down the bedrock of our current prosperity, pricing carbon will ensure that the Australian economy of the 21st century remains globally competitive.

The carbon price is less than four months old, but we have already seen the beginning of Australia's transformation to a low carbon economy.

We should remember these are early days, and the carbon price will need to continue in order to encourage innovation and investment in new clean technologies well into the future.

Your industry has an interest in this policy continuing. Your industry, and the national interest, is not well-served by Tony Abbott's recklessness.

I look forward to the constructive role the banking and finance industry can play over the next twelve months and beyond.

Thank you.