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## Transcript:

**CONVENOR;** Ladies and gentlemen, welcome to the National Press Club and today's National Australia Bank address. We are delighted to welcome back to the National Press Club Professor Ross Garnaut, a Vice-Chancellor Fellow from the Melbourne University and also the key adviser to the Government and, indeed, the Parliament on the future for climate change action in Australia. Professor Garnaut today is releasing, along with his taskforce, the sixth in a series of eight papers, laying out a framework for climate change action. He will report by 31 May to the Gillard Government with his final report. From then on, it will be up to the Government to respond. Please welcome Professor Garnaut.

[Applause]

**ROSS GARNAUT;** Thanks Steve. Well, here we are again. Good to see Tim Costello here. I didn't know Tim was coming when we stood up together, from opposite sides of the aisle in the plane coming up here. He said, good luck. David and Goliath. I said, well, biblical analogies don't come so quickly to my mind, Tim. I thought more of Bob Simpson being called out of retirement to face the West Indies attack after Packer took our top order. Tim said, well, he made a century.

David Pever, the managing director of Rio Tinto was just behind us, and said, well, he took a few bruises from Malcolm Marshall along the way through. I said I'd take the century.

[Laughs]

I always enjoy being with you at the National Press Club. We're here together on climate change after having been here on climate change twice in 2008. I think we would have been all been surprised if the president on one of those occasions had said that I'd be back again on climate change in 2011. But here we are again.

I'm back for a good reason. Climate change is a real and important problem for Australia. If we do not deal with it effectively, it comes back again and again and again. It will not go away just because some of us swish it away. But after a while we may be left only with choices that do unnecessary damage to the Australian standard of living. So this is an important new chance to get it right.

As I said in the science update paper last week, the evidence from the science is stronger than it was two and three years ago. Much of the raucous discourse surrounding climate change policy in Australia today is there because quite a few Australians, including some prominent Australians, don't think climate change is real.

There is no point in covering up the truth. We are living through an awful contest between knowledge and ignorance.

I said in the science update last week that two leading authorities on the statistical analysis of time series had examined the international temperature data for the review update, and

had confirmed their conclusions for the 2008 review. *"The temperatures recorded in most of the past decade lie above the confidence level that is produced by any model that does not allow for a warming trend."*

I noted that the publication of the statistical evidence on a warming trend had not stopped assertions in the public debate that the earth was cooling. I said it does seem, however, to have discouraged at least the numerate and rational from repetition of errors.

Well, the Australian airwaves late last week still resounded with talk of the earth cooling. Let's be clear: if human-induced climate change were not real, the right policy would be to do nothing. This should be the first and main debate. There's a healthy turn in the public discussion that we've been debating the science over the past week.

Is it real? Should we be doing something effective about it? I concluded the science update where I concluded that part of the 2008 review. It would be imprudent beyond the normal limits of human irrationality not to take serious steps to mitigate the risks.

Once we have settled that vexed but simple matter we face up to the diabolical policy problem. The only effective action is global. The chances of effective global action will be greater if Australia contributes its full proportionate share at each stage of the global effort.

Some Australians take comfort in kidding themselves that our proportionate share at this time is nothing or not much, because the rest of the world is doing nothing or not much.

Update Paper Two a few weeks ago, provided information on the reality, that other developed countries and significant parts of the developing world are doing much more than us. That's not a clever position for us to be in, as the developed country that stands to lose most from unmitigated climate change. Some countries are setting out to reduce emissions in costly ways. That's not clever either. I hope that we can avoid that mistake ourselves.

We are fortunate that the international community agreed in Copenhagen and Cancun on an objective that is in Australia's national interest, to hold the global temperature increase to two degrees Celsius, which roughly corresponds to 450 parts per million of carbon dioxide equivalent in the atmosphere.

All developed countries have accepted targets to reduce their emissions. The outstanding feature of global action on climate change at the moment is the action in the major developing countries. Led by China, they have moved more quickly and further than I had anticipated in 2008, towards changing the relationship between their economic growth and their greenhouse gas emissions.

There is bipartisan support in Australia for reducing 2000 emission unconditionally by 5% by 2020. This is not an easy target. On current policies we are tracking towards an increase of 24%. Both major parties are committed to changing plus 24% into minus 5% in just nine years. If we take a year to get policies in place, it's just eight years.

As the evidence emerges of international action, our proportionate part will require us to reduce emissions more than that. So we need policies that put us on a path now to achieve a reduction of emissions of more than a quarter below business as usual by 2020 and then to go further, in line with international action.

If we are clever we can apply mitigation policies that have relatively little effect on the increase in our living standards in the years immediately ahead, while contributing our proportionate part to international action.

The alternative is to suffer a major loss in productivity growth and in unnecessary reduction in our living standards; now, from unnecessarily expensive mitigation policies or later, as we face the consequences of failure of the international mitigation effort. Once we have decided that we are going to reduce emissions by a larger amount, we have to decide how we will do it. It makes sense to do it in a way that carries the lowest possible cost.

The United States Government is moving seriously to meet its target of reducing emissions from 2005 levels by 17% by 2020. Following the loss of control of the House of Representatives, the Obama administration is seeking to achieve its goals through federal regulatory interventions, supplementing a plethora of state and local measures.

Secretary for Energy Steven Chu explained to me a few weeks ago how the United States was seeking to put some economic discipline into its regulatory decisions by applying a social cost of carbon. At first \$21.00 per ton and rising steadily over time. This is a rigorous exercise, which will reduce the cost of achieving reductions of emissions through regulation.

But there are limits to how much you can reduce the cost of mitigation through better regulatory decisions. Despite the administration's best efforts, the United States Government is still adopting an expensive approach to reducing emissions, because it has no choice.

Some Australians say that we should follow America into regulatory approaches to reducing emissions, simply because that is where they are now heading. That reminds me of how eminent New York economist Jagdish Baghwati used to characterise a common argument for trade protection. Beware, he would parody the protectionists, I will keep shooting myself in the foot until you stop shooting your feet. Well, I don't think that we should shoot ourselves in the foot just because the American House of Representatives has shot America's foot.

There are two basic types of approach that we could apply in reducing Australia's emissions. One is by placing an economy-wide price on emissions that reflects the cost that they impose on the rest of society. This is a market based approach. The other is by regulation of activity through which firms and individuals are required by law to refrain from emissions intensive activity to an extent that adds up to the required reduction in emissions.

The market based approach provides incentives for individuals and firms to reduce their emissions whenever they can find a way of doing so that is less costly than paying the carbon price. It causes consumption of every item that embodies a high degree of carbon emissions to be discouraged and every consumption of every item that embodies fewer emissions to be encouraged. It causes production of emissions intensive items to be discouraged and leads to expansion of production of goods and services that can be made with fewer emissions.

We can't identify in advance where all of the reductions in emissions will come from. They will come from everywhere. Once market incentives are in place, individuals and firms will be looking for them from everywhere. This is the way markets work. It is why models of market driven structural change almost always overestimate the cost. Individual consumers and producers think of millions of ways of doing things differently than are in the minds of the economists who build the models.

I was reminded of this a couple of weeks ago as a senior officer of the administration of the European Union Emissions Trading Scheme explained that the European Union was being pleasantly surprised by the costs of the reducing emissions and that this was encouraging greater ambition in the setting of targets.

By contrast, the regulatory approach requires interventions by government to influence every consumption and production decision by individuals and firms. Some part of government must make calculations and assumptions about activities that can reduce emissions. Someone in government guesses that the costs of reducing emissions by these means. Government then sets rules to constrain consumption of some goods and services, and therefore to encourage consumption of others and to encourage production of some goods and services and discourage production of others.

The market based, relative to the regulatory approach, requires many fewer decisions by government and much less intrusion into private decisions.

There was for a while in the Twentieth Century a great contest of ideas about whether market based or regulatory approaches to managing the economy were more conducive to economic welfare. The regulatory approach went under the name of central planning. Picking a few areas of action and seeking to reduce costs through encouraging competitive approaches in those narrow areas is a variation on a regulatory theme. For those of us who remember the Berlin wall and, heaven forbid, Tito's Yugoslavia, it is the Yugoslav variant of central planning.

That contest of ideas was won decisively by the market economy. It was not won in theory. It was won by observation over time of the results respectively of market based decisions and regulatory interventions.

A market-based approach achieves reductions of emissions at less cost. It allows us to address the equity objectives most effectively and, if we are wise, also supports productivity raising reform of the tax system through the revenue that it generates. This is the policy approach that is in the Australian national interest.

Today there are few who think systematically about the economics, who doubt that the application of a broad based carbon price, a market based approach is the central element in a cost effective way to reduce emissions.

To speak as I have about knowledge from science and about the superiority of markets over regulation, can sound politically partisan in the current environment. It is a sad thing for our country that it should do so.

Three years ago I spoke to leading figures in what was then the Howard Government and then the coalition opposition about my review. I was thinking and writing and saying similar things to those that I'm saying today. I hope I've learnt a bit in the intervening years but the core of my recommendations has much in common with my recommendations in 2008.

Then I was recognised by both sides of politics as someone who was working on a problem that we all saw as important and within an approach that was broadly shared. If some participants in the political process have changed their positions on the proposals that I am putting forward, it is not that I have changed in a way that makes me more partisan.

Incidentally, the editorial in this morning's *Australian* says that I sound less concerned about trade exposed industries now than in the 2008 report. I suggest that the *Australian* looks at my recommendations today and then.

I've always been worried about the distorting effects of differential carbon constraints across countries on the trade exposed industries. I've been especially concerned about the risk that undisciplined responses to pressure for assistance from affected industries could take us back into old Australian troubles from tailor made protection and protection all round. The recommendations for trade exposed industries that I present today can manage those risks.

Now, as in 2008, an emissions trading scheme, initially with a fixed and rising price, is the best instrument for long term emissions reductions in Australia. Exactly what I said in 2008 as well. This provides the benefits of credibility and steadiness in its early years as industry and institutions build confidence and capability with later international trade and abatement allowing emissions reductions to take place where they are cheapest. It also provides substantial revenue.

Two important decisions need to be made in implementing an emissions trading scheme that starts with a fixed price. The starting price and how much the price rises over time, and the timing, conditions and manner of transition to full emissions trading.

For Australia the price must deliver on several objectives. It must be credible in the face of what science tells us is necessary, as well as in response to public and business expectations. It must help us to make a proportionate commitment as a developed country to an international effort. The price must meet what we've committed to do, domestically and internationally.

Australia's had in place since 2008 an unconditional target to reduce emissions by at least 5% by 2020. Based on past modelling, to meet this target it is likely that Australia's carbon price would need to commence at around \$25. We need to be ready to tighten our targets in line with international action so that the initial price should not be too low. Explicit carbon prices present in existing international markets, and where economy wide carbon pricing policies are present, are also a consideration.

Future linking and trade in entitlements will occur more smoothly if the gap between Australian and overseas carbon prices is not too great. New data and modelling from the Australian Treasury will be an important source of information for Australians to understand

the potential economic impacts of a carbon price and to make a judgement on a suitable starting price.

For a scheme to have the desired international effects and to endure, the starting price must give the right signal on the path to a credible scheme. Australia's price should contribute our proportionate part in resolving the international prisoner's dilemma. It must prepare Australia for its role in a more ambitious and demanding global agreement. I suggest that a starting price should be between \$20-\$30 and, once it's set, that it should rise at 4% in real terms per annum. This rate of increase has a sound conceptual basis that I explained in the 2008 review.

The transition to a floating price can be managed by providing investors with sufficient notice and clarity about when and the conditions under which the shift will occur. There are advantages in fixing the date of transition in advance and in working to ensure that adequate opportunities for credible international trade in entitlements are available by the time of transition. There is every chance that this will occur.

The update proposes that a definite date for the transition be agreed and it favours three years, that is mid 2015. The only reason we should not move is if an independent review suggests that there are insufficient international trade opportunities to secure liquidity and stability in the market.

A firm target for reductions of emissions over time will need to be established in advance of the movement to a floating permit price. Australia's current unconditional target for 2020 or a more ambitious target judged at the time to be appropriate or negotiated in establishing a regional market will guide the price path in the market.

Later targets should be recommended through independent reviews with processes and governance similar to that employed by the UK's Committee on Climate Change.

To support a smooth transition to a floating price, institutions and supporting infrastructure should be established from the beginning of the scheme. With a price on carbon we can reduce the potential cost to the economy by ensuring revenues from a carbon price are used wisely. The update proposes a package of measures directed to where the rationale for assistance and expenditure is strongest. The largest use of revenue should support an efficiency-raising reform of tax and social security; the Henry Tax Review provides one model.

The reform should focus on cutting taxes and reduce the marginal effect of tax rates in the bottom half of the income distribution. This will be an effective way of dealing with most progressive income distribution effects of the carbon price. It will also raise labour force participation and use the capacities of our people more effectively, at a time of labour shortage.

Transport fuels should be part of the scheme. There are difficult geographical distribution effects of an immediate increase in petrol prices. I suggest funding a once off reduction in excise by reform of the Fringe Benefits Tax on motor vehicles; this will have superior environmental, economic efficiency and equity effects than the excise that it replaces.

For the future I have in mind some geographically differentiated fiscal arrangements and will discuss these in my final report. A substantial amount of revenue should be allocated to transitional assistance to emissions intensive and trade exposed industries to remove distortions that arise if other countries are applying weaker carbon constraints.

Up to 15% of the revenue value of permits should be applied to the linking of carbon farming initiatives, Kyoto offset credits to the Emissions Trading Scheme and the purchase of non-Kyoto land sector abatement credits by the regulatory authority. I discussed this at length in the paper on land sector sequestration, a couple of weeks ago.

If opportunities to purchase offsets are fully utilised, the value in 2020, in last year's dollars, would be \$2.25 billion for rural Australia; almost exactly to the value in last year's dollars of last year's wool clip. It would be adding another wool industry to rural Australia.

The update also examines the case for transitional assistance for innovation and to ensure energy security. This will be discussed in update papers seven and eight. Today I will focus, in these final minutes, on the largest claims to assistance.

A carbon price has been criticised by some commentators for its impact on economic growth and employment. Such criticisms generally ignore the substantial benefits against which any costs should be set. These criticisms also fail to appreciate the opportunity for productivity enhancing tax reform associated with a carbon price.

The 2008 Review outlined the case for transitional assistance to emissions intensive trade exposed industries. Those industries whose emissions are high per unit of output and who are highly exposed to competition through trade. There are two propositions upon which this case is built.

First, imposing a carbon price in Australia through a price on carbon or through other means such as regulation or direct government expenditure which proceeded or exceeded that of countries that are the host to major competitors, could result in some movement of emissions intensive trade exposed activities from Australia to other countries that impose less of a carbon constraint.

This could result in an increase in global emissions in the event that the activity moves to a country that uses a more emissions intensive production process than Australia. This is the universally recognised environmental risk of carbon leakage. This risk cannot be quantified precisely without a lot of work. The risk is real, but is exaggerated significantly in popular discussion. Fears about carbon leakage are overblown but remain a powerful obstacle to the introduction of effective mitigation policies the world over. So this paper deals with them.

Second this could cause Australian production to contract below the level that would eventuate if our competitor countries faced a similar cost. Having a rigorous approach in place to address the competitiveness distortion is important; without it competitiveness' concerns will remain a barrier to implementation of a domestic carbon price. Worse, they can undermine the integrity of our policy-making processes.

I support a principled approach to emissions intensive trade exposed industries upon the implementation of a carbon price. The principled approach was explained in detail in my 2008 report. However, it will take some time for the data and independent institutions to implement this approach to be developed. We therefore must wait in the introduction of that principled approach.

While we are working towards the establishment of the institutions and data to apply the rates based on the principled approach defined in the Review, a more approximate approach is necessary. As an interim approach, for three years, I suggest the expedient of applying an approach based on the Government's original proposal in its Carbon Pollution Reduction Scheme white paper for a period of three years from the commencement of the scheme.

It has been developed through considerable public and private resources. The detail has been settled and at one stage it was widely accepted within affected parts of the business community. This can only be an interim approach while we develop the institutions and data for a principled approach.

One important modification of the arrangements that were part of the Government's final scheme that I recommend, is the removal of the global recession buffer, which led to an increase in the rates of assistance for emissions intensive trade exposed sectors. The Global Financial Crisis at least in its effects in Australia is over and the special arrangements that were put in place as a buffer against that crisis are no longer appropriate. Without principles or total quantity constraints there is no logical limit to emissions intensive trade exposed industry assistance.

To have the greatest potential to constrain unwarranted payments priority should be given to data collection and analysis of industries likely to be at the greatest competitive disadvantage and the largest drain on assistance; I note those in the paper.

The development of and administration of the principled approach must have independence. The scheme itself must have an independent regulator with the type of constitution

protection that is provided to the Reserve Bank of Australia. If you like, the Carbon Bank. The independent regulator would set levels of assistance under the principled approach.

Assistance would be funded from sale of permits prior to the return of proceeds of permit sales to consolidated revenue. On these assistance matters the independent regulator will be required to receive and to consider advice from an independent expert body with the characteristics of the Productivity Commission.

The independent expert adviser would consult publicly and transparently on its method and data sources. Its recommendations and the approach upon which it was based would be made public. The process for this important set of decisions will be considered further in the final report.

I would just like to underline the importance of having an independent governance structure underpinning all of these arrangements. An independent regulator, independent advice to the regulator on important decisions related to assistance to trade exposed industries and also in another sphere on the setting of targets and aspects of the transition to a floating price.

The collection and analysis of data can be accelerated through international cooperation such as through the World Trade Organisation. An international approach would ensure globally efficient outcomes while making the assistance regime more stable domestically.

Economy-wide carbon pricing is back on the Australian agenda for two good reasons. First the climate change problem is real and large. Second it is better to make our contribution to a solution by using efficient and low cost policy instruments than expensive policies which unnecessarily reduce the Australian standard of living.

The climate change problem can only be solved if all countries with economies of substantial size make proportionate contributions. International cooperation on this scale requires international agreement. The international community, like Australia with its domestic climate change policies, is making multiple attempts at policy. Remarkably, the international community is now making progress.

If we are clever we can apply mitigation policies that have relatively little effect on the rise in living standards in the years immediately ahead, while contributing our proportionate part to international action to provide substantial protection for the Australian standard of living in the more distant future.

This update paper presents a package of policies that meets these objectives which makes sense for the future, for our place in the international community and separately for Australia alone. We can at the same time, play our part in the global agreement and introduce policy reform that is the national interest.

As I said in 2008, no mitigation policy solution will seem optimal or acceptable to everyone. That is certainly true of this package. Indeed, this is partly because it is designed to be right for Australians as a whole. This update paper is an interim report on a policy package which can provide a basis for discussion. The final report at the end of May can consider responses to these proposals.

This Australian parliament this year will be deciding more than whether it will make a contribution to climate change mitigation. It will be choosing whether it continues with market based policies that support continued growth in productivity and incomes or whether Australia descends into a regulatory mire, surrounded by all the political economy interventions that gave Australia for eight decades of the 20th Century the lowest productivity growth of all the developed countries. Thank you.

**CONVENOR;**

Thank you Professor Garnaut for that address. We now turn to questions from the working press. The first question today is from Lenore Taylor.

**LENORE TAYLOR;** Professor Garnaut, you recommend that the new carbon price be used to fund new personal income tax cuts. What proportion of the revenue from permit sales should be used for personal tax cuts, how much of Dr Henry's big tax cut and welfare reform vision would that pay for and how does that recommendation sit with your other recommendation that the CPRS compensation for trade exposed industries – I don't know if you'd call that the unprincipled approach – be capped for the first three years?

**ROSS GARNAUT;** Thanks Lenore. I have in mind about half of the revenue going to a package of tax and social security reform, an integrated package directed at reducing marginal effective rates and cutting taxes in the bottom half of the income distribution. You can do some simple arithmetic and see that that will pay an awful lot of Henry type recommendations.

I don't want to get too far into the detail. Other people, like the treasurer no doubt, will have views on those things but we can get a long way towards a large productivity raising reform of tax and social security at the bottom of the income distribution – in the bottom half of the income distribution.

**CONVENOR;** Next question from Phil Hudson.

**PHIL HUDSON;** Professor Garnaut, Phil Hudson from the *Herald Sun*. There's a lot of confusion about this in the community. I guess as you point out, the different sides of politics have different arguments on this, but what's your message directly for the individual households who they say that they recycle at home, they try and curb their water use, they try and be as energy efficient as they can but then they hear all the debate going on about this, they see that they're going to be hit with a carbon tax and then have the money given back to them as a tax cut?

Do you understand why people think this is a confusing money-go-round and what is your one message to them about why you think they need to do this?

**ROSS GARNAUT;** Overall, low and middle income earners in Australia will be better off directly, as a result of these arrangements, and in addition future generations of their family will be protected from dangerous climate change.

**CONVENOR;** Sid Maher.

**SID MAHER;** Sid Maher from *The Australian*, Professor Garnaut. You say in the paper that you want targeted structural adjustment assistance for any regions that are vulnerable to large scale loss of livelihood as a result of the implementation of the carbon price. Could you just give us a picture of how you see the transitions?

Julia Gillard was talking about transitions last night in Adelaide too. Can you give us a picture of how you see the transitions in the economy? For example, do you see the coal industry being as big or bigger in the coming decades, the manufacturing industries that opponents I guess of carbon pricing tend to cite when they raise objections to the scheme?

**ROSS GARNAUT;** Yes the coal industry as a whole will be much more affected by what other countries do than by what Australia does, because most of the demand for our coal is overseas. The coal industry as a whole will be much more affected by whether China is discouraged from its current very large nuclear program than it is by the carbon pricing in Australia but there are some parts of Australia, and I suppose I'm thinking especially of the Latrobe Valley in

Victoria, which currently have a lot of their employment in very emissions intensive electricity generation.

I say in the paper that the best structural adjustment assistance is pre-emptive, helping structural adjustment in those regions before there is unemployment and regional distress. Those regions happen to be very good regions for building some of the lower emissions generation capacity and in my final report I'll be talking a bit more about some of the ways. Carefully targeted and well designed transitional arrangements could help those regions use their advantages in the industries of the future.

**SID MAHER;** If I could just follow up on that, are you suggesting then that the Latrobe could become a sort of a green jobs hub and that – I'm not sure how many workers are employed by the power generators down there but they could transition from coal across to green jobs? Is that essentially what you're talking about?

**ROSS GARNAUT;** Well the first transition would be in to grey-green jobs. As the relative importance of coal in power generation in Australia declines, the relative importance of gas will arise. If we're going to put in a new gas fired power station somewhere that has all of that infrastructure of the Latrobe Valley, is a very good place for that.

In addition, those very rich energy sources have a lot of other uses if you can manage the emissions but the very first cab off the rank would be thinking of the new gas based capacity that has to be part of Australia's energy future.

**CONVENOR;** Laura Tingle.

**LAURA TINGLE;** Professor Garnaut, Laura Tingle from *The Financial Review*. You've talked about a principled approach to ET assistance. Is there a principled approach to the trade exposed sector? What about a national consumption policy model for emissions trading?

Wouldn't unions and business buy that policy approach more than the production based approach that you're suggesting, and if I could, what would be the positives and negatives of trying a sectoral approach first, particularly for the electricity generation sector only?

**ROSS GARNAUT;** Two large questions there Laura. Maybe the second one first, the sectoral approach. The problem with a sectoral approach is that you're delaying the beginning of adjustment in all the other sectors. If you just applied arrangements to electricity to start with, well you start the structural change there but you don't start it anywhere else and the big growth in emissions in Australia is fugitive emissions from exports of energy of various kinds.

If we get too far behind the curve it's going to be harder and harder to get people to start calculating in the costs, the effects of reducing emissions in those other sectors. So it is just more time lost in the race if we delay in starting on other sectors.

Now in the land paper I explained some very good reasons why we don't want to include the land sector now except as a supply of permits. On the consumption approach, there are a couple of points to make about that. There are two issues here, one is how that will be seen internationally, and secondly, what its effects will be domestically. For good or real, the world some time ago settled on judging each country's efforts in reducing emissions by how much emissions were reduced in activities that were going on within the borders. When a steel mill closes in Britain and opens in China - that used to happen, it doesn't happen anymore - if that happened, those emissions are counted in China and you get a reduction in emissions in Britain. That's how the international community chose to do things. For us to go the other way would be like choosing ourselves to drive around American roads on the wrong side of the road. We wouldn't go for very long.

There's a separate question whether in meeting our domestic emissions targets, which are partly set by recognition of international expectations, whether we would do better to focus on reduction in emissions that we consume. The first point to be made there is that we would have to reduce them a lot. It may be that some unions and producers would think that was better, to the extent that they had less of an adjustment burden. Of course it would be a larger burden on other elements in the community.

One issue there, is that if other countries are doing something and they are, then simply depending on - focussing on domestic consumption and not looking at all at emissions in the tradeable good sector, which is rather a large part of our economy, will mean that effectively, we are subsidising trade exposed emissions intensive industries.

If other countries are taxing all of their production in their country and we are not, then us doing that alone will mean that we are in fact putting less pressure on our own trade exposed industries to reduce emissions than other countries are.

Under the principle approach that I outline, that is automatically taken into account. The consumption approach from that point of view would be fine, if no other countries were doing anything. But if other countries are doing something and more over time, then my approach will have an automatic adjustment in the amount of assistance as other countries do more.

**ALEX HART;** Professor Garnaut, Alex Hart from the Seven Network. In 2009 you described the Rudd Government's emission trading scheme model as one of the worst examples of policy making you have ever seen. Given the difficulties faced by the Prime Minister currently, obviously the citizen's assembly promise, the broken carbon tax promise, trying to appease the Greens and Independents, opposition from the Opposition and perhaps some public scepticism, are you worried that history is going to repeat itself?

**ROSS GARNAUT;** I wasn't talking particularly about the Rudd Government's approach. I was talking about Australia's consideration of that policy issue. There are a number of unsatisfactory features of that. One of the most worrying for me and I have the advantage of - disadvantage of having grown up as an economist in the old days of Australian protection when we killed our productivity growth -we made ourselves the worst performing developed country in the world through our all round protection - was that we seem to be getting back into a world where favours were negotiated by individual businesses where there weren't disciplines on the policy process.

The end point of that is not just some small resource allocation difference from one industry being a bit smaller or a bit bigger. The end approach of that is you undermine the integrity of the whole policy making process. We demonstrated in Australia how important that is when we got rid of that high protection. We got rid of that protectionist political culture.

When we did that, we went through a period when after eight decades of having, with New Zealand, the worst performing economy in the world in terms of productivity growth for developed countries, we became for a while the very top performer in the nineties. We stayed there for a while. Now we've had a bit of a battle again in the last ten years. It was that descent back into the protectionist political culture that I most had in mind when I described the policy making process as being the worst in living memory.

**ALEX HART;** Just in that vein, are you then concerned about some of the talk of so called carbon tariffs coming from within sections of the labour movement, the Labor Party? Are you concerned that this debate that we are having and will have, could see those sorts of issues come to the fore?

**ROSS GARNAUT;** Well I'm not concerned yet because there is no sign of the people who will be making important decisions conceding to those pressures. I've outlined a principled approach that

can deal with that problem, that can avoid our getting back into a protectionist culture. At its heart, there is an independent system of governance giving transparent advice on these questions.

The sort of role the Productivity Commissioner has played in unwinding Australian protection, I think if we follow that approach, we've got a good chance of avoiding that outcome. Of course there will be try-ons around the place. That's necessary. That's actually a duty of a union leader or a chief executive of a company to try and squeeze a bit out of the government against the national interest if they can. If you've got the right institutions in place, you've got a protection against that. I've recommended the right institutions.

**CONVENOR;** Paul Howes will be relieved to hear you say that. Andrew Tillett.

**ANDREW TILLET;** Andrew Tillett from the *West Australian* Newspaper, Professor. Just back on the tax cuts idea that you floated. How would you structure them in a way so that high income earners wouldn't get a big tax cut from it so that most of the revenue would go to low and middle income earners? How important do you think it is to overcompensate low and middle income earners? Finally, by linking tax reform to a carbon price, don't you then run the risk of inviting criticism that this is just about wealth redistributions rather than saving the planet from cooking?

**ROSS GARNAUT;** Well I think it's very important to save the planet from cooking. If at the same time you can reform the tax system and make us all more productive, then that's a good thing. You can do it at the same time without any compromising of the environmental objective. The precise design? A number of ways you can do it. The Henry Tax Review had one set of proposals. That's one way you could do it. There are other ways you could do it, but if you just want one model, that's one possibility.

**CONVENOR;** Next question from Julian Drape.

**JULIAN DRAPE;** Julian Drape from Australian Associated Press. The Prime Minister last night said that if Australia didn't adopt a carbon price this year, we probably never will. Do you agree with that statement? Do you also agree with her or what's your view on her statement that the Greens' view on climate change is extreme?

**ROSS GARNAUT;** I didn't hear the Prime Minister last night so I won't - so I don't know exactly what she said. I'll just say that, in the discussions I've had with all members of the multi-party committee on climate change, it's been a constructive discussion. People trying to find out - to work out what's best in Australia's national interest. I think we'll get there this year. I hope I won't be back at the National Press Club in 2014.

**CONVENOR;** Simon Grose.

**SIMON GROSE;** Simon Grose from sciencemedia.com.au. One of the most sobering forecasts in your current series of update papers is in paper three where you forecast that global emissions will double between 2005 and 2030 on a business as usual basis. I understand that business as usual incorporates the Copenhagen - assumes all the Copenhagen

undertakings are fulfilled. This includes - your forecast includes that China's emissions will rise I think 5.6% on an annual basis averaged over that time. I think India is 6.6%.

In that context, let's assume we have a carbon price in Australia starting next year along the lines you predict. Let's further assume that you go back to one year earlier gigs and you're a prime ministerial adviser. In the run up to the 2019 election, the PM comes to you and says, Ross, the punters have been paying for their carbon for the last six years, and the price has been rising a bit. They also see that the global emissions are rising, so the price that they're paying for their carbon is not having the effect they want. What would you advise the PM to tell the voters?

**ROSS GARNAUT;** Thanks for that question, because it may give me a chance to clarify something that I didn't know was unclear. Paper number three wasn't a forecast of emissions. It was a projection of what would happen under business as usual, without any mitigation policies, and that did have emissions doubling by 2030. Now, the good news is, we're already a long way away from business as usual, and the biggest step away from business as usual is what has been done in China.

My starting point, however, was on trying to estimate where we would end up without any mitigation policies, and that was necessary as a first point, because in a way that was an indication of the mitigation task. Now, already we have things well below that. The biggest single element of that is China, but there is also a significant element in the commitments in the United States. Europe is now making some headway. Indonesia's commitments are substantial. India has made a commitment to move away from business as usual, which it had refused to contemplate up until a year or so ago.

So the good news is, we've already moved quite a long way from that, but that was calculations if given economic growth, the energy intensity of that growth in the absence of mitigation, and the emissions intensity of energy in the absence of mitigation, what would the world look like? That gave us an indication of the task that we were approaching. So I think things look quite different once you have that background. I thought it was clear in the paper. I'm sorry if it wasn't.

**CONVENOR;** Next question from Steven Scott.

**STEVEN SCOTT;** Steven Scott from the *Courier-Mail*. Professor, you mentioned the issue of petrol prices, and how you may need to look in the future at possible regional adjustments to help people in regional areas. Could you give us a bit of a flavour of what you're thinking there? Secondly, when you're talking about compensation to low income households, is there a danger that if there is too much compensation that some consumers simply won't change their behaviour?

**ROSS GARNAUT;** On the petrol, I've proposed a very specific thing. I've said that petrol should be part of the scheme, but the first step, the introduction of the initial carbon price, can be balanced by a once for all reduction in excise, paid for by reform of the fringe benefit tax. This happens to have a better environmental effect, equity effect and economic efficiency effect than the excise that it replaces. After that, the increase in the carbon price will affect relative prices.

There is a difficult regional distribution in effect of that, in outer suburbs, and rural Australia. I am working on some ideas there, and I'll talk about them in the final report, but I don't want to go off in a half baked way. That's keeping something for the final report.

And the question of compensation, no, there's no risk. If someone is paying more for electricity and getting more after tax income through a tax cut, or a social security adjustment, they still have a full incentive to economise in the use of electricity. It's the relative prices of the emissions intensive good, or service, relative price of electricity compared with other prices, that affects incentives to use it.

The idea of a carbon price is to change relative prices. Collecting the money and giving it back in an efficiency raising tax cut does not in any way diminish incentives to economise on use of emissions intensive products.

**CONVENOR;** Our final question today is from Deb Nesbitt.

**DEB NESBITT;** Deb Nesbitt from Thomson Reuters. Professor Garnaut, I'm wondering if you'd agree with the Australian Industry Greenhouse Network - that represents a lot of the companies that would become liable under a carbon pricing scheme - that the federal government should use a threat of withholding GST payments, or grants commission payments to the states, to force them to cease or to get out of the climate game, as it was put to me, to cease their climate programs that undermine the market mechanisms.

The example, of course, is the renewable energy target, and the feed in tariffs at state level that some argue undermine and make that price collapse. Do you agree with that, that the states should be forced out of this, and that they could continue to undermine the pricing mechanism?

**ROSS GARNAUT;** I'm very sympathetic to the premise of the question, but no, I don't agree with the solution. Federal/state financial relations and the use of GST revenue is frankly a mess. It has been ever since that political deal to get the states to support the GST back in 2001. What used to be a relatively minor element of our federation, the horizontal fiscal equalisation through the grants commission, suddenly became a big deal, and it distorts a lot of things.

To then start distorting it a bit more by saying we're going to fiddle around even more with this, and make it even more distorted so that you do the right thing on climate policy is not the way to do it. That's not to say there's no problem with the proliferation of interventions of the kind that you mentioned. I'll make a beginning in talking about that in the electricity sector in paper eight, and say more in the final report. Unwinding those things over time has to be an important objective, but we've got to find a way of doing that that doesn't complicate even more the difficult federal/state financial relations associated with use of GST revenue.

[Applause]

**CONVENOR;** Thank you very much, Professor Garnaut, for your appearance today. Despite any reluctance on your part, we would welcome you back at the National Press Club and I'm sure as this debate does gather momentum there will be an opportunity - perhaps not 2014 - for you to appear. I'd like to present you with a small gift today, of membership to the National Press Club. It's a gold membership card, which includes your code to get into our car park, and also a gilt edged pen to write your final report. Thank you very much, Professor Ross Garnaut.

[Applause]

**ROSS GARNAUT;** Thank you. Thank you very much.

- ENDS -

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