

## 12 Choosing the future

WE CAN NOW return to the assessments of the national interest and discussion of the obstacles in the way of good policy with which we opened the book. We have to decide whether it is in our national interest to do our fair share or to lag behind others in the mitigation effort. Then we have to decide how we go about doing our fair share.

In forming our assessments of the national interest, two main questions have to be answered: Is the science legitimate? And what is the relationship between what Australia does and what the rest of the world is doing?

On the first question, the material presented in Chapter 1 confirms the central propositions from the science beyond reasonable doubt. The central propositions of the mainstream science on climate change are accepted by most Australians. This provides a basis for effective policy action.

On the second, there would be no reason to participate in a global effort to reduce greenhouse gas emissions if there were no prospect of effective global action. Chapter 4 demonstrates the reality of widespread international action to reduce emissions. This has shifted the world well below business-as-usual emissions growth. Current action holds out the possibility of evolution into strong global action that realises the international community's objective of holding temperature increases to below 2°C.

Here we are dealing with facts, not beliefs. I hope that people who oppose Australian action to reduce greenhouse gas emissions on the grounds that others are not acting will directly respond to the facts presented in this book. Differences can then be identified and additional information sought to resolve them.

Those who oppose Australian action on the grounds that others are not reducing greenhouse gas emissions can be comfortable with the recommendation in this book, that Australia strengthen its target in line with the average of international action.

There is, however, another line of argument about international action that is used by those who oppose Australian action on mitigation. This is the argument that Australia is an inconsequential country. What Australia does and does not do, according to this argument, has no effect on the actions of others. Therefore Australia should do nothing and save its money, whether or not the rest of the world is taking action. That way Australia will benefit from what others do if they are taking action, and save money if they are not.

The view that one country's actions have no effect on other countries is present in all but the largest countries, but outside Australia is recognised more clearly for what it is: an excuse for not acting on climate change. The argument dissolves once it is recognised that there is no need to make a once-for-all decision on Australia's share of an ambitious global mitigation effort. What is important is that we make it clear that we are moving with other countries, and are prepared to contribute our fair share to ambitious action if others are playing their parts. We can all build towards strong mitigation, each of us observing the actions of others and moving further in response to what we see.

What we are dealing with is a problem in which the solution requires collective action. It is not an unusual kind of problem in domestic or international affairs. Indeed, the difference between civilisation and anarchy is above all the capacity of society to find a basis for efficient collective action when it is necessary to solve a problem of great consequence.

Australians who don't want any action on climate change make the point that we account for only a very small proportion—just under 1.5 per cent of total global emissions—so that what we do has little direct effect on the global total. This is a true but trivial point. And, while the United Kingdom's share of global emissions is not much larger than ours—about 1.7 per cent, despite it having three times our population—it hasn't occurred to a British prime minister from Margaret Thatcher onwards that Britain's efforts are unimportant. And nor are they. The influence of British ideas has been considerable.

But the view that Australia doesn't matter is common enough in Australia for us to have to answer the question: is ours truly a country that doesn't count?

We could seek an answer by listening to what others say.

In Melbourne in March, the Chinese minister with responsibility for climate change policy and also energy policy, Vice Chairman of the National Development and Reform Commission Xie Zhenhua, told me that China's emissions reduction commitments would not be affected by inaction in Australia. But, he added, it was crucially important not only that Australia meet its unconditional target of reducing emissions by 5 per cent by 2020, but make the target more ambitious in line with the efforts of other developed countries. This would, he said, encourage others whose commitments were explicitly or implicitly conditional.

Xie was not saying that Australia doesn't matter.

The United States ambassador to Australia and officials in Washington reporting directly to the president have asked me not to underestimate how

strongly the outcome of the current Australian policy process will feed back into the US discussion on climate change. Australia is seen as sharing some of the same characteristics of the United States, including high per capita energy use and emissions and an exceptionally large role for emissions-intensive industries in the political process. Our decision to follow the Bush administration into failing to ratify the Kyoto Protocol, after being a party to the agreement negotiations, made us the developed country whose example was cited most often in the US domestic political debate. Acceptance of carbon pricing in Australia, said the ambassador and others, would help the chances of strong mitigation action in the United States.

Count this against the doctrine of Australia as an inconsequential country.

The recognition of Australian influence is clearer and stronger in other countries in our western Pacific neighbourhood.

In the course of my work over the past four years, I have discussed climate change policy with leading members of the Indonesian cabinet on half a dozen occasions. Indonesia is certainly not an inconsequential country: it is the fourth most populous country in the world; the third largest emitter of greenhouse gases; the largest country with a Moslem majority; the international policy leader of Southeast Asia; and the third biggest economic growth success story of the Platinum Age. Indonesian leaders are closely interested in what Australia might or might not do. They would be amazed to hear that some Australians think that Australia doesn't matter.

Then we can look at the historical record.

Direct experience has left me with no doubt that Australia has the standing, the analytic capacity and the diplomatic skills to significantly influence international policy on issues. When there is compatibility between the interests of Australia and the countries we are seeking to influence, and on which we ourselves are acting consistently with the shared international interest, that influence can be decisive. Climate change is such an issue.

I have been involved in a number of issues of this kind on which Australia has exercised substantial influence over the past three decades. One was persuading China that we shared a mutual interest in China developing its wool textile and steel industries with large-scale use of high-quality raw materials from abroad. A second was the influence of the idea of concerted liberalisation of trade across the countries of the western Pacific. From the middle of the 1980s until the Asian financial crisis of the late 1990s, Australia was an influential agent in the 'open regionalism' on which the Asia-Pacific Economic Cooperation forum was built during its first decade. A third was the

sustained diplomatic effort that made agriculture an important focus of trade liberalisation in the Uruguay Round of trade negotiations, after neglect dating back to the beginning of the modern international trading system.

On all of these issues, Australia's influence depended among other things on our demonstrated commitment to domestic trade liberalisation—we were showing that we really believed that we shared an interest in open trade. That helped to make us influential.

There is wide recognition, in the United States and Southeast and Northeast Asia at least, that Australians are good at working out effective ways of organising international cooperation on particular issues, and at marshalling support for international cooperation around those ideas.

On the climate change issue, I would count the embodiment of 'pledge and review' in the Cancun Agreements—countries pledging their own commitments to emissions reduction and having them reviewed by other countries—as a consequence of Australian influence. 'Pledge and review' was introduced into the Copenhagen conference when it was in crisis by the Australian team, and became centrally important to President Obama's discussions with leaders of China and the other major developing countries.

And what if we applied the logic of Australia as an inconsequential country to strategic issues? Are our troops in Afghanistan, and were our soldiers on the Western Front in World War I, more influential than we could expect our contributions to shared efforts on climate change to be? Was Australia's commitment of the lives of so many of its young people in war and so much expenditure on defence over a hundred years really irrelevant to the shape of the world in which we make our lives? Would everything be exactly the same if we had decided at the beginning that our presence in Afghanistan would not affect the outcome, so that we might as well use the people and money comfortably at home?

Clearly the argument that Australia has no influence on what others do is a path into quicksand.

If the rest of the world were taking strong action to avoid dangerous climate change, and if it were true that Australian decisions were entirely inconsequential to global outcomes, would we really be comfortable to take a free ride on the efforts of others? That is not where we usually want to place our country in international affairs.

And would others be comfortable about our free riding on them, so that there was no retaliation for what others saw as inadequate contributions on climate change, and no effect on cooperation on other matters of importance to Australia?

No-one would expect the answer to be ‘Yes, Australian free riding would be fine’.

Since it is not possible for Australia to be a leader in reducing greenhouse gas emissions because others are already too far ahead, we should do our fair share in what the world needs to do. Let us look forward to a future in which Australia, within the recommendations in this book, is doing its fair share in a global effort.

For some time we will be behind. That is a pity, because Australia is not an inconsequential country.

A pity, but it is where we are. And it would have a positive effect if Australia were to announce that we had established mechanisms that would allow us to catch up over time with the average effort of developed countries, and to stay there once we had caught up.

The first thing that we have to do in catching up is to make sure that we deliver the minus 5 per cent target that we have pledged formally to the international community. It would certainly damage the international effort if we looked as if we would fail. The resources boom means that we are further behind now than we were three years ago, notwithstanding the current form of the Renewable Energy Target and other policies that have been introduced over the past few years.

The introduction in 2012 of an emissions trading scheme with a fixed price on carbon for three years and then a floating price incorporating the targets that are appropriate at that time would give us good prospects of doing our fair share at moderate cost.

A starting price around \$26 would make a difference to many decisions. Businesses would begin to take account of their greenhouse gas liability in a systematic way. Goods and services embodying fewer emissions would become a bit cheaper relative to other things.

We would all be aware that the carbon price would rise. This would have a larger effect on investment than on current production.

Business leaders would be on notice that we would be moving to a floating price with an emissions target in three years, so long as the conditions were there for international trade in entitlements. They would be looking at developments in other countries’ carbon markets for a guide to the price at which our own system would settle as we entered into international trade. They would be calculating that it would probably be higher than the initial fixed price. They would calculate that the carbon price would be higher still if the world were becoming more ambitious in its emissions reduction targets.

Business leaders would also be aware that the price of entitlements will rise as the exchange rate falls with the end of the resources boom. Low-emissions industries are competing with the resources industries, just like our hotels, universities, factories and farms. They will become more competitive as the resources boom ends, just like the other tradeable goods and services industries. They will expand and prosper in competition with imported foreign emissions entitlements as the resources boom eases. If we have set up our institutions and policies well, the rapid expansion of our 'import replacing' low-emissions industries will be part of the increase in activity in the rest of the economy that holds up incomes and employment as the resources boom fades. Potential investors in high-emissions industries will realise that they will face greater competition as the exchange rate falls after the resources boom ends and that will discourage investment now.

If we follow the path suggested in this book, the introduction of the emissions trading scheme with an initially fixed price, and the subsequent movement to a floating price, will be important but not disruptive events in the structural evolution of the Australian economy. As soon as the parameters of the scheme are settled, business will focus on making money within the new rules, rather than on securing rules that make them money. That makes it essential that the rules really are settled. The governance arrangements proposed for the carbon pricing scheme are the key to establishing settled rules: the independent carbon bank to regulate the scheme; the independent climate committee to advise on targets and the transition to a floating price regime; and the independent agency to advise on assistance to trade-exposed industries.

Trade in entitlements would begin the convergence towards similar carbon prices across many countries. New regional trading arrangements might emerge. Each member of a regional trading arrangement of which Australia was a participant would be free to sell and buy entitlements with others so that carbon prices for our region would move closer to those elsewhere. Confidence would grow that trade-exposed industries were facing similar carbon constraints in many countries. It is likely that countries that initially chose not to take part in international trade, but which were meeting commitments to reduce emissions, would be imposing at least similar costs on their trade-exposed industries.

As the world places constraints on emissions-intensive industries—whether through the European Union's emissions trading scheme or China's direct action or in other ways—the prices of the products of these goods and services will rise more than other prices. If Australia remains a country with

a comparative advantage in emissions-intensive goods when many countries including Australia are applying similar carbon constraints, we are likely to still be a large exporter of such products. The higher product prices will allow our producers to buy entitlements from abroad.

However, where there are more and less emissions-intensive ways of making the same things, the more emissions-intensive ways will lose out in the marketplace. We can be sure that if we are working within a strong global mitigation scenario, coal soon and natural gas later will cease to be competitive everywhere unless economically efficient sequestration technologies have emerged. That does not mean that we lose our advantage in energy-intensive industries. After an adjustment period in which new investment goes to various sources of low-emissions energy that are currently underutilised in the developing world, our natural advantages in a wide range of low-emissions energy sources are likely to keep us competitive as a location for energy-intensive industries.

One condition needs to be placed on the expectation that Australia will remain an internationally competitive location for energy-intensive industries in a world of strong, global carbon constraints. We have many natural advantages for low-emissions energy, but their commercial emergence will require technological innovation, skills and investment. It will require the rest of the world to see us as a good location for innovation and investment in low-emissions energy.

We will need to be seen as one of the countries that is focusing on encouraging the industries of the future and not only on protecting the industries of the past.

From the time of the floating of the carbon price, probably in 2015, the professional advice from the independent climate committee will help us to do our fair share as other countries' efforts increase. Our carbon price then rises over time as the increase in the global effort is reflected in a rising international emissions price.

We would have embarked upon the transformation towards the low-carbon economy of the future.

All Australians want to know where the new jobs and incomes will come from in a low-carbon economy. This question is related to another one: where will we find the savings in emissions that meet increasingly ambitious targets?

These were the questions that were always on people's minds as we began to reduce protection over a quarter of a century ago. The answer that my economist colleagues and I would give at the time never sounded convincing: 'From everywhere.'

‘Any trade-exposed industry that is competitive in some overseas markets now’, I would say, ‘will become more competitive in all overseas markets, and expand. Some industries that are on the edge of being internationally competitive now will go over the edge and become exporters. Some managers in trade-exposed industries will recognise that continued competitiveness will require new ways of raising productivity, and go looking for them, and find them. Some that now depend on protection will not find ways of raising competitiveness, and their output will decline. The new jobs will be as numerous as the old jobs that have been lost.’

Well, now we know where the new jobs came from in the years after the reduction of protection. They came from everywhere. Many were in manufacturing and services industries, which increased their exports. And they were better jobs with higher pay than in the old, protected industries.

So it will be with the reductions of emissions under the market-based scheme proposed in this book. They will come from everywhere. Consumers will use less energy and other goods and services that embody high levels of emissions. Natural gas exporters will try harder to find opportunities for sequestration of fugitive emissions and the wastes from liquefaction. Landowners will think hard about the parts of their properties that would have more value as carbon sinks than they do carrying sheep. Lots of people with clever ideas of doing things in ways that reduce emissions will find equity investors and lenders more interested than they were before. Every producer will think about whether it is more profitable to spend a bit to reduce emissions, or to buy more permits.

The modelling for the 2008 Review made certain assumptions about technologies in various industries, embodying cautious views on how the technologies might change over time. That gave us one picture of how the economy would evolve if we did our fair share in a strong global climate change response, and another for our share in a weaker global effort. It showed where the emissions would be reduced to reach our targets—minus 25 per cent by 2020 and minus 90 per cent in 2050 under a strong objective—under one set of assumptions about technology. The costs of meeting our targets were manageable even if there were no extraordinary breakthroughs in technology.

What I can tell you for sure is that the outcome will not look exactly like that. It may not look much like that at all. Once we put the carbon pricing incentives in place, millions of Australians will set to work finding cheaper ways of meeting their requirements and servicing markets. We don’t know in advance what the successful ideas will be, but I’m pretty sure that there will

be extraordinary developments in technology. That will lower the costs of our transition to a low-carbon economy. The reductions in costs will go faster and further with the support for innovation suggested in Chapter 9.

That is the genius of the market economy. That, above all else, is why West Germany absorbed East Germany and not the other way around, and why South Korea is doing so much better than its northern neighbour. That is the reason why Australian productivity growth was so near the bottom relative to the rest of the developed world from Federation through to the mid-1980s and so high in the 1990s. That is why the United States could afford the Cold War and the Soviet Union could not. That is why economic growth accelerated in China, Indonesia and India once they had scraped away the barnacles of protection.

And that is why reliance on regulatory approaches and direct action for reducing carbon emissions is likely to be immensely more expensive than a market approach.

Direct action would have some rationale if we wanted to pretend to take action against climate change but not do much.

If we didn't do much—and remember that we would be doing quite a lot to meet our minus 5 per cent commitment to the international community—we would run great risks for Australia. It would be contrary to our national interest because it would make a strong global mitigation outcome less likely. It would be against our national interest because it would lead to our political and economic isolation and eventually to action being taken against us in international trade and other areas of international cooperation.

We would be damaged in other ways, too, if we sought to do our fair share through direct action. We would rely on the ideas of a small number of politicians and their advisers and confidants. While some of these ideas might be brilliant, in sum they would not be as creative or productive as millions of Australian minds responding to the incentives provided by carbon pricing and a competitive marketplace.

And even if the leaders upon whom direct action was relying were much smarter than the rest of us, their ideas would not be disciplined by the cold realities of the marketplace. The market has the great virtue that it quickly culls an innovation that is not proving its promise. The direct action of a politician or a bureaucrat can be kept alive on taxpayers' money, in the hope that something will turn up.

That would not be the end of the costs.

The really big cost would be the entrenchment of the old political culture that has again asserted itself after the late 20th century period of reform.

The big rewards in low-emissions investments would go to those who had persuaded the minister or the bureaucrat that their idea was worthy of inclusion in the direct action plan—if not under the government that introduced the direct action policies, then under the governments that followed. That would entrench the return of the influence of the old Australian political culture in other areas of economic policy.

And we would be leaving really difficult challenges to the Australians who follow us. In the best of circumstances we would be bequeathing them a climate that is far more difficult to live in than the one into which we were born. It would be even worse if we also left them a political culture that was incapable of the flexibility—through the use of effective markets—that will be essential to Australian adaptation to a world of climate change.

