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An open economy prioritises the climate and so prosperity

Check against delivery

Thanks very much to CEDA for the invitation to speak today. I have a long association with CEDA and a deep respect for what you do.

There is considerable focus on this year's budget, due in less than a week, in particular because the Government's "Future Made in Australia" theme has naturally reignited some old issues.

Under a Made in Australia heading some argue that other countries have changed their approach to so called "industry policy" so we should also. Of course, doing things because others are doing them can lead you to strange places.

Some argue that the economics of the past are flawed and we now need to take a new approach to economics. But sorry, the laws of economics are not that flexible.

But economics certainly has fads. One such is that the smaller the role for government the better. There is no economic logic to this, within limits, provided the larger role for government is matched by higher taxes to pay for it.

The net zero transition is an unprecedented opportunity for our economy that does require greater government involvement to stimulate private sector investment. We should not be beholden to rigid or flawed views about the role of government provided there is a sound underpinning for these interventions.

There can be a challenge in the term “Future Made in Australia”. At first glance it is inward looking and does not appear to recognise the net zero export opportunity.

But there are signs that the Government recognises the huge opportunity for Australia from leveraging our comparative advantage in the net zero world.

We will know within a week.

1. Focussing on Australia’s comparative advantage

Australia has likely the world’s best combinations of solar and wind energy resources, and it has enormous potential sources of biomass for a zero emissions chemical industry. Renewable energy and hydrogen are expensive and difficult to export, so it makes economic sense for a range of energy intensive industries to now be located in Australia.

Take the example of iron metal. Australia currently exports the iron ore, the metallurgical coal used to reduce the iron ore to iron metal, and both thermal coal and gas which can be the heat sources for the iron making process. Australia is the largest exporter of the first two products, and is a major exporter of the latter two.

Some have long said, and are still saying, that we should use all these Australian ingredients and make iron metal in Australia now. But there is no logic to government intervening in the choices the market has made; it seems best for Australia in the fossil carbon world to do as we are.

In the coming zero carbon world, however, it makes sense to make green iron in Australia.

Green iron will very likely need green hydrogen as the reductant that gets the iron ore into iron metal. Making green hydrogen requires a massive amount of renewable energy to power electrolyzers that separate the H₂ (Hydrogen) from the O (oxygen) and to provide the heat for the green iron making process.

Green iron should be made in Australia simply because the economics flip in the net zero world. Exporting metallurgical coal raises its cost by perhaps 5–10% while exporting hydrogen more than doubles its cost via a complex and difficult

process. Likewise, renewable energy should be used close to where it is produced as it is also difficult and expensive to export.

All overseas studies that I am aware of suggest that Australia is likely the cheapest place in the world to make green iron. **And those seeking to make green iron by importing hydrogen, those studies say, will be uncompetitive.**

The world needs Australia to make many green products because we have massively more low cost renewable energy resources than we need. **We can be an exporter of energy intensive green products.**

Countries such as Japan, Korea, China, and most of Europe do not have sufficient even moderate cost renewable energy resources to make all the electricity they need domestically. They will need to either import renewable energy, ammonia as a derivative of hydrogen, and/or use nuclear energy – all at great cost – simply to meet their domestic electricity needs.

It follows that they will need to import many goods with the green energy intensity embedded in them to meet their climate targets. Australia's advantages relative to the rest of the world are such that we can materially improve the prospects of achieving the world's climate objectives.

In addition to our just over 1% of world emissions now occurring in Australia, we could remove around another 6–9% of global emissions that other countries will find very difficult to abate by making, for example, green iron, green aluminium, green transport fuels, green urea and green silicon in Australia.

By turning our iron ore into green metal alone Australia would reduce world emissions by over 3%; close to triple the contribution to world emission reduction from decarbonising Australia.

Australia covers about 5% of the earth's land surface; supplying about 7–10% of the world's renewable energy is no stretch given our abundant solar, wind and land resources.

Indeed, if Australia seizes the opportunity it can repeat the experience of the China resources boom which peaked around 10 years ago. But this time the opportunity can be sustained, rather than boom and bust, and we can manage it better for broadly based development.

But we must be externally focussed.

Under the Hawke Government Australia went from being insular and inward-focussed to an externally focussed economy determined to take advantage of the coming Northeast Asian ascendancy. We reduced tariffs, removed bottlenecks and benefitted from the huge growth to come from our near neighbours.

We can again benefit provided we remain externally focussed.

2. A larger role for government

As I have said, to realise this opportunity there is a large role for government, as befits the huge transition and this opportunity. The Government's role is to unlock private sector investment.

First, and most important, the Government needs to address the two externalities that it is crucial to recognise in the net zero transition. One is the negative externality associated with the damage caused by carbon emissions. It is silly that we want to reduce emissions, but we do not want to use a price incentive to do this. So green products are currently more expensive than products made with fossil fuels because the latter do not pay for the damage they cause. This needs to be addressed in some way.

Then there is the positive externality from the benefit to others by the early movers taking new technology to scale for the first time. The benefits to others are the expensive learning by doing, with benefits to followers that the original investor cannot capture.

Second, is a need for the public sector to play a large role in providing the 'natural monopoly' services such as hydrogen storage and transport, and electricity transmission, given that supply needs to be built ahead of demand, that all should be able to connect into these systems, and that rate of return regulation in private ownership often biases to higher costs for consumers.

Third, there also needs to be a commitment to open trade, which as we all here know has been the underpinning of Australia's past success.

This means we should not follow the USA Inflation Reduction Act approach of being inward looking and protectionist. Australia's best approach for its own prosperity and to make the best contribution to world emission reduction is to be outward focussed, relying on the lowest cost inputs from around the world.

Indeed, we should make access to markets for Australia's energy intensive green exports a major focus of trade policy. Initially there will need to be a strong focus on the markets of Northeast Asia (Japan, China, Korea) and Europe (including the UK, and others that are not members of the EU).

Fourth, we need to boost resources and adjust procedures so that approvals processes for projects are considerably streamlined, which they can be while ensuring vital First Nations and environmental issues are appropriately dealt with.

There is no logical reason why Australian project approvals take as long as they do. We need active policy here, not begrudging regulation.

Fifth, we need to ensure the Government's excellent Job Skills Australia initiatives, in addition to boosting a number of trades such as electrical trades, restores Australia's strengths in geoscience, metallurgy, chemical engineering and other skills we will need. Australia has allowed these core skills to wither, and this must be reversed.

Of course, all of the above needs to be paid for, particularly in the future as needs grow.

Australia must maintain a strong budget position to ensure Australia has a low cost of capital given that the products mentioned above require extremely capital intensive investments.

With this in mind Ross Garnaut and I have **recommended the introduction of a Carbon Solutions Levy (CSL)** at all fossil fuel extraction sites in Australia (around 105 sites), and on all fossil fuel imports to Australia.

We urge the CSL's introduction by 2030-31 at the latest as expenditure ramps up.

We have suggested that the CSL be imposed on all emissions from Australian fossil carbon extraction wherever they occur in the world, at the level of the EU's

carbon price (five year inflation-adjusted average, currently around \$90 per tonne of emissions).

To avoid a double imposition, sales to any country with arrangements that impose a penalty on the carbon content of imports, as the EU's Carbon Border Adjustment Mechanism (CBAM) will do from 2026, from which Australian zero-carbon goods can benefit, would receive a rebate for those sales. We hope that by 2030, our major trading partners in Northeast Asia would qualify for exemption so that Australian zero carbon goods are competing widely on a level playing field with products that contribute to global warming.

In this way we hope that the CSL can encourage countries beyond the EU to adopt their own CBAMs.

We have also suggested that an amount of the CSL proceeds should be kept for budget repair or funding structural reform, such as tax reform.

Increasing taxes is very difficult to impossible in Australia. But I believe the logic for taxing fossil fuels is the strongest, and so provides our best chance of seeing the higher tax levels Australia needs.

3. The Budget and Australia's next phase of prosperity

So, what do I hope to see in the budget due in 6 days' time?

First, and most important, I would like to see the main focus on addressing the externalities and bottlenecks in our economy just mentioned in Section 2.

Second, there should be clear qualification rules and a framework for support so that discretion over individual projects is limited.

Third, **I would like to see a focus more on comparative advantage, as discussed in Section 1 above, rather than competitive advantage.** Leveraging David Ricardo's comparative advantage means focussing on our innate advantages, as described above. Michael Porter's competitive advantage comes from what you create. A country may try to create a competitive advantage, but these are tricky bets.

I accept countries can create their own competitive advantage, just as companies can, but it requires very careful analysis and must hang off some underlying strengths. There are not many such opportunities when we do not have an underlying comparative advantage.

Fourth, I would like to see strong mention of Australia's opportunity to reduce world emissions by 6-9% when we seek to fully leverage our comparative advantage. This gets way too little attention in our climate debate even by people who claim to be concerned about climate change, which is a world problem.

Indeed, I have heard stories of projects that can help boost our green energy intensive exports being held back by arms of government to avoid in any way damaging our domestic agenda of 82% renewables by 2030, as we seek to decarbonise Australia and reduce world emissions by around 1%. This is idiocy.

There must be no trade-off if we are interested in world emission reduction!

Finally, there should not be too much emphasis on self-sufficiency. As Ross Gittins said in last Saturday's paper:

"...self-sufficiency is a great way to be poorer than we need to be.....When we insist on making items we are not good at, those things will cost more than importing (them).....jobs created in the inefficient part of the economy come at the expense of jobs in the efficient part...."

Arguments for making things here, so we have some element of self-sufficiency, require very close scrutiny. For example, we have long used the self-sufficiency argument for making particular defence equipment in Australia. Note how much more we have paid for locally built rather than imported navy ships.

We need to understand what we are concerned about that may limit our access to particular goods, why in those circumstances self-sufficiency is important, what are our alternative sources of supply and, most important, what are the consequences of our choices.

The appropriate approach to a "Future Made in Australia", which focuses on the green export "Superpower" opportunity, can bring enormous benefits.

If Australia achieves green energy intensive exports at the lower end of the 6–9% it can, over time, **achieve additional export revenue of \$250–300bn per annum**. This is way greater than the \$120–220bn per annum revenue we receive from coal and gas exports, which will decline over time.

Note that coal and gas prices are volatile; current prices are high but are expected to normalise over the next year or two.

We will also see higher productivity as more resources are employed in sectors that will see continuing change and learning.

There will be higher paying, sustainable jobs as our scarce labour is directed to sectors that can compete internationally, rather than in ones that cannot and are constantly under threat.

The benefits will flow widely, including to those outside our cities. There will be more Indigenous employment as our best solar resources are up north.

More, Australia will have a clear sense of direction.

This prompts a final thought. Some argue the world will not decarbonise sufficiently for there to be significant demand for the green products described above. That, of course, is potentially an existential problem if correct.

But it also ignores the contribution Australia can make to convincing the world to deal with climate change.

Australia can help show the world that we can decarbonise products that our society relies upon, such as metals, transport fuels, silicon and fertiliser, in an economic way, and that increasingly, costs will fall as scale grows.

Those who say that Australia cannot make much of a contribution to dealing with climate change are so wrong.

Thank you for your attention today.

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About the Superpower Institute

The Superpower Institute's purpose is to help Australia seize the immense economic opportunities of the post-carbon world. With unparalleled renewable energy resources and our 'clever country' scientific and engineering capabilities, Australia is perfectly positioned to be a green export superpower in the world of net zero emissions.

The Institute specialises in the regulatory settings and market incentives needed to make Australia an economic superpower and provides practical knowledge to governments and industry to realise this opportunity.

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