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Carbon impost a recipe for low wages

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Illustration by Eric Lobbecke. Source: The Australian

NEXT year, each man, woman and child in this country will pay \$450 in electricity charges for "green schemes", including the carbon tax, renewable energy targets and solar feed-in tariffs.

That totals more than \$10 billion; but not even Julia Gillard claims those outlays get us anywhere near that amount in environmental benefits.

Indeed, far from trying to defend them as achieving credible environmental goals, the government is reduced to claiming those costs won't hurt a bit.

No one has pushed that line harder than Climate Change Minister Greg Combet. Speaking after the NSW regulator's recent finding that the carbon tax would raise NSW electricity prices by 8.9 per cent, Combet trumpeted that finding as showing the tax's effects were even smaller than Treasury had suggested. With Treasury's modelling estimating an increase for NSW of 9 per cent, Combet demanded Tony Abbott "apologise to the people of NSW" for a "deceitful scare campaign".

But there was not a peep from Combet when the Queensland and ACT regulators came in well above the Treasury estimate. And had Combet read the reports he purports to cite, he would know the regulators' findings refer to an increase in the regulated price ceiling, not the average charge actually paid.

As prices actually paid are significantly below the ceiling while the carbon tax will be passed on in full, the effective increases are about 10 per cent in NSW, 13 per cent in Queensland and near 15 per cent in the ACT, substantially exceeding those Combet has claimed.

The economic harm those increases will cause is made all the greater by the renewable energy target and solar feed-in tariffs. Thanks to those policies, electricity prices, even without the carbon tax, are already much higher than they need to be. And when a tax is piled on top of another tax, the pain increases more than proportionately.

So going from the 10 per cent price distortion associated with the renewable energy targets and the feed-in tariffs to the 22 per cent price distortion with the carbon tax added does not double the economic costs of these so-called environmental measures: it increases them fourfold.

And even that is an underestimate. Electricity is an input to the production of virtually all goods and services. When electricity prices are above efficient levels, producers reduce their electricity demand, replacing electricity with other inputs whose costs may be higher but whose prices are less steeply marked up. This compounds the economic harm, as it lowers productivity and makes producing goods and services costlier than it should be.

Because that inefficiency depends on how firms respond to higher input prices, the loss is not easy to quantify. But an approximation can be derived using Treasury's modelling to calculate by how many dollars Australia's income falls for each dollar the carbon tax raises in revenue. That is a rough measure of the "excess burden" of a tax, which is the extent to which it not merely transfers income from taxpayers to the government but cuts incomes overall.

It captures, in other words, the extent to which the pie shrinks when the tax office takes its slice.

Using, for simplicity, a 1 per cent discount rate, the present value of the income loss from the carbon tax is nearly twice the revenue it raises. That implies the carbon tax has an average excess burden four times greater than that of the most distorting tax identified by the Henry report. And of course, Treasury's carbon tax modelling assumed a credible international agreement on emissions reduction is reached relatively soon. Were such agreement not reached, the income loss could be two to three times greater.

For every dollar of revenue this tax raises, it would then ultimately reduce income by four dollars or more, whereas raising the same dollar of revenue by our present most distorting tax would only cost some 50c.

That the costs are so great is understandable, as we are the only country in the world imposing a carbon tax on trade-exposed, emissions-intensive industries - not least mining, on which our prosperity depends. But even here, Combet insists, you won't feel a thing.

After all, he argues, those producers will get allocations of free permits. Averaging the zero price of gifted permits with the price of the permits producers have to buy, the carbon tax, he says, will be "as low as \$1.30 a tonne", so that the harm to production will be minimal.

But Combet's claim is nonsense. For firms' decisions do not depend on the average price, but on how much they can save by reducing production. If avoiding one tonne of emissions saves \$23 in carbon tax payments, then it is that \$23 - the price at the margin - that matters, as it is the gain from producing less.

Even Gillard understands that. Despite an allocation of free permits, she has said, "there would still be an incentive for industries to reduce emissions", as "businesses would reduce their emissions, sell their surplus permits and actually make money". And there is one clear way to do that: cut production - and jobs with it.

It is therefore hardly surprising Treasury's modelling not only had prices rising as a result of the carbon tax but wages falling too. It had to for the economy to remain at full employment. And while the government says most households will be compensated for price hikes, it has never suggested it could offset the wage declines.

So why are we bearing these costs? Claims the schemes help avoid dangerous climate change are scarcely credible, all the more so in the week China was shown to be understating its carbon emissions by 20 per cent, an amount equal to Japan's total emissions.

Rather, these schemes have become part of a vast, opaque set of taxes on wealth producers used to fund redistribution on a scale with few parallels in Australian history.

And of course, they pander to the Greens. Their electorate is happy to see living standards fall for those outside the sheltered workshop of public-sector jobs, so long as they can retain the lifestyle to which they are accustomed.

Rather, like Tolstoy, they want to re-enact peasant life in part of the house, while enjoying their creature comforts in another. These monks may hanker for the wilderness, but it comes with air-conditioning attached.

And with others footing the bill. A large bill it will be too. For robbing Peter to pay Paul invariably makes both very poor indeed. Struggle with the truth as he may, not even Combet can hide that.