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# Never mind the sentiment, the maths is all wrong

**HENRY ERGAS** THE AUSTRALIAN MARCH 31, 2014 12:00AM

**THERE is no passion, said Georges Clemenceau, like that of a functionary for his function. He must have had the Clean Energy Finance Corporation in mind, as it battles the Coalition's election commitment to abolish it.**

Faced with those efforts, voters may wonder about the propriety of public funds being used to sabotage the policies they so recently endorsed. After all, the CEFC was not set up to advise on climate policies but to implement the legislation Labor and the Greens had put in place. That its board and management have chosen to divert taxpayers' money into a campaign to prolong their existence seems unbecoming. But the CEFC believes it answers to a higher calling. Indeed, CEFC chairwoman Jillian Broadbent argues its claims are so compelling that Tony Abbott should shred his pledge to end the $10 billion program.

Those claims are certainly startling. Apparently, each dollar invested in the CEFC not only more than pays for itself financially but reduces emissions to boot. The Climate Change Authority estimates it could cost up to $65 a tonne in 2020 to reduce domestic emissions. The CEFC, however, says the emissions reductions it achieves cost a negative $2.40: that is, taxpayers get both a unit of abatement and a cheque for $2.40.

That is not a free lunch, it's a free feast. But during a campaign, Henry Adams reminded us, the air is full of speeches and vice versa. And although the air in this case may be emissions free, the CEFC's campaign is no exception to Adams' rule.

Unfortunately, unpicking the CEFC's "hot air for nothing'' analysis is like chewing on a wet sponge: much spillage, scant nourishment. But donning the green eyeshades throws up errors and omissions so numerous one scarcely knows where to start. In essence, the CEFC borrows at the government bond rate, say 3.5 to 4 per cent, and lends at slightly above 7 per cent to abatement-related projects that, in theory, would otherwise struggle to find funding on reasonable terms.

The CEFC treats the government bond rate as its cost of funds; assumes it will secure the cash flows associated with its interest charge and with repayment of the principal, minus a modest provision for bad loans; and claims the margin between those as a profit to taxpayers. That profit it compares to the alleged emissions reductions, yielding the "negative cost'' per tonne abated that is at the heart of its case.

But each and every step in this analysis is incorrect. For starters, when taxpayers issue public debt to invest in risky projects, the burden they incur is not just the 4 per cent at which they borrow, but the higher taxes they will have to pay to cover potential losses. Properly measured, that burden turns out to rarely be any lower than the cost at which the project could borrow commercially: which is why schemes such as those the state banks of Victoria and South Australia devised, in which government debt funded low-interest loans to uncertain private ventures, have proven so ruinous.

As a result, the CEFC simply errs when it treats the commonwealth bond rate as the cost to the community of the funds it employs. To make matters worse, however, it treats its own loans as being close to a sure thing. Yet even a small probability of default means the effective expected return is well below the headline interest rate.

For example, if the probability of default is 15 per cent, the average interest rate required to actually achieve a 7 per cent return is 26 per cent; in that case, a 7 per cent headline rate, far from yielding taxpayers the 3 per cent margin the CEFC claims, results in a 13 per cent loss.

To all that the CEFC then adds the sin of double counting. In effect, the only reason the previous government allowed the CEFC funding at the bond rate was the potential benefit in terms of abatement. In other words, even it recognised those funds were being loaned at a loss, but offset that loss against the social value of the emissions reductions. Yet the CEFC contends that loss is a profit and then trumpets the abatement as if it were a further gain on top of that.

Not that it is easy to accept the CEFC's claimed emissions reductions. Its major wind farms already existed; excluding those, it is difficult to believe its other projects could provide anywhere near the abatement it asserts.

Nor could anyone readily accept the claim that those other projects would not otherwise have proceeded: on the scant information available, they yielded cost savings so vast (with internal rates of return exceeding 100 per cent) that even the beneficiaries should have happily underwritten them.

But those beneficiaries would, of course, have been even happier shifting the costs on to taxpayers, with the extraordinarily high implied subsidy rates on the CEFC's projects making their celebrations all the merrier. On highly plausible assumptions, those subsidy rates are in the order of 60 per cent. And for its wind farms, which have also benefited from myriad other sources of public support, they imply the private owners obtained a total of $75 in taxpayer funding for each $25 of their own money, while pocketing the entirety of the profits.

No wonder the CEFC has a backlog of applicants, which it proudly points to. And no wonder those applicants have touted so loudly on its behalf: the cheaper the crook, the gaudier the patter. But far from attesting to its merits, they highlight the folly of the undertaking and of the Labor-Greens pact from which it sprang. That pact is now a bad memory; no matter how well intentioned its board may be, it's high time the CEFC joined it.

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