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IMF’s gift to anti-coal jihadis is vastly overvalued

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Illustration: Eric Lobbecke Source: Supplied

Widely cited claims by the International Monetary Fund that subsidies to fossil fuels amount to a staggering 6.5 per cent of global income have been savaged by David Henderson, former chief economist of the OECD, in a letter to London’s Financial Times published on Friday.

Describing the IMF’s staff study as giving “ground for concern about (the IMF’s) current procedures”, Henderson points to a flaw in its calculations. And he argues the IMF’s estimates reflect a “novel” definition of subsidies that twists the concept beyond recognition — and certainly beyond policy usefulness.

The IMF's results, which the green lobby has relied on heavily in its jihad against coalmining, are therefore "best viewed as speculative rather than conclusive or even remotely plausible".

But with anti-coal activists preferring personal invective to rational debate, those concerns are hardly likely to lead the jihadis to think again.

Henderson's criticisms are partly technical. Having estimated what they consider to be the subsidy to fossil fuels, the IMF economists then expressed it as a share of world output. However, in adding up individual countries' GDP they used current exchange rates, rather than "purchasing power parities", which — as the IMF itself has long recognised — better measure real incomes.

As a result, they understated world output by some 40 per cent, inflating the ratio of subsidies to world output from 4.7 per cent to the even more headline-grabbing 6.5 per cent.

The crucial issues, however, go deeper. Take Australia: as conventionally measured, subsidies to coal, mainly for R&D, amount to about $130 million a year, which is less than one-tenth of 1 per cent of Australia's GDP.

The IMF study, however, claims Australian coal is subsidised by $14 billion, a hundred-fold increase over the conventional approach. It gets there by calculating the taxes it considers ought to be levied on coal to correct for alleged environmental damage, and then defining the revenue forgone by not imposing those taxes as a subsidy.

Now, the IMF can call anything it wants a subsidy, so long as it makes its methodology and data clear, which it has. The trouble, however, is that just as Moliere's Monsieur Jourdain had spoken prose all his life without realising it, so on the IMF's definition we are dispensing vast subsidies of which we are entirely unaware.

Chocolate? Given its contribution to obesity, it is presumably hugely "subsidised", since governments don't tax it sufficiently to drive us to a far healthier life on kale. As for soul-dulling television, the IMF would doubtless conclude that until MasterChef was so heavily taxed that viewers switched to Wagner's spiritually uplifting Ring cycle, it too was being "subsidised" on a scale that dwarfed global GDP.

Perhaps; but there is, in the belief that one can accurately identify such an idealised benchmark and measure our distance from it, more than a hint of Hayek's "fatal conceit". And the results aren't likely to be closer to the mark than central planners ever are.

For instance, to estimate "optimal" environmental taxes, the study relies heavily on models of climate change; but even Harvard's Martin Weitzman — a co-author of Climate Shock and nobody's idea of a "denier" — recently lamented that climate modelling has not progressed in 35 years.

As if that wasn't bad enough, it is even more disturbing that, with little explanation, the study revises the fund's own estimate of global subsidies to coal in 2011 from the $740bn it published in 2013 to more than $2.7 trillion.

If the estimates a team of 23 IMF economists presented to world leaders as "comprehensive" barely two years ago were wrong by a factor of four, how much confidence can this latest pronouncement deserve?

All that must cast doubt on the IMF's approach; but even were that approach sensible, its implementation would still be questionable.

In effect, while conjuring purely hypothetical "subsidies", the study lets the real ones to renewables scamper by unnoticed. However, if apples are subsidised by 20c while oranges, their close substitute, are subsidised by $4, then far from being assisted, apples are heavily taxed. Nor are those orders of magnitude imaginary: the annual income transfer to renewables in Australia is in the order of $2.8bn, 20 times the public funding that goes to coal.

By simply pretending those subsidies don't exist, the study gets its base case wrong, overstating the gap between current outcomes and its benchmark.

Yet assume nonetheless that the study's estimates of the damage fossil fuels cause are correct; its claim that taxes on energy should skyrocket still wouldn't follow. Rather, that would only be the case if doing so caused no harm to other policy objectives, notably economic growth.

That is an assumption the study makes, as does Christine Lagarde, the IMF's managing director, in endorsing its results. But less than a year ago, Lagarde hailed lower energy prices as "good news" for the world economy.

Sure, there are differences between an external price change and a self-imposed tax; but it strains credulity to suggest China and India could increase coal prices by nearly 900 per cent and 450 per cent respectively, stifling energy use, without the slightest damage to living standards and income prospects.

That is all the truer as history shows getting politicians, rather than markets, to set prices leads not to the study's "ideal corrective taxes" but to misery. And preventing the world's poor from accessing the low-cost energy they need to rise out of poverty is not just foolish — it is, as Josh Frydenberg has argued, immoral.

None of that is to chastise the study's authors: like Henderson, they take debate seriously. Not so our anti-coal jihadis, as Bernie Fraser's outrageous attacks on Frydenberg make clear.

Parroting data they barely understand, they prefer darkness to light. And as they turn off the world's power, that is exactly what we will get.