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Climate policy a burning issue

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TO get an intelligent answer, ask an intelligent question. It was the failure to do so that undermined the modelling of the carbon pollution reduction scheme. From the snippets Wayne Swan released on Wednesday of carbon modelling 2.0, it has exactly the same weakness. Not that the snippets lack interest. Most striking is just how large the costs of the new scheme are estimated to be.

According to the Treasurer, per capita incomes will grow by 1.2 per cent annually. The scheme is expected to reduce that growth rate by 0.1 percentage point. That reduction, Swan claims, is a mere trifle. But it amounts to a permanent 8 per cent cut in our long-term growth rate. To see what that implies, consider the present value of the forgone income; that is, the absolute value of the cost to 2050. That present value is in the order of $1.4 trillion. The proposed policy would therefore cost Australia about 1 1/2 years' national income. But even that large amount is a significant underestimate, assuming the modelling is similar to that done for the CPRS.

First, it assumes moving to the scheme involves no transition costs. But resources are not infinitely malleable. Substantial costs would be incurred not merely in moving to the scheme but also if we eventually wanted to abandon it.

Second and even more important, the modelling assumes our commercial rivals are implementing a similar scheme. Given that assumption, the modelling does not assess the government's proposal. Rather, it models an entirely different policy: that of introducing an emissions trading scheme when such a scheme is being introduced by our competitors. To cost the government's proposal, one therefore needs to ask a more sensible question: what are the consequences for Australia of acting unilaterally? If doing so only doubled the adverse impact on our growth rate, the policy's cost would exceed three years' national income. Of course, the government denies it is acting unilaterally. Rather, pointing to the Productivity Commission's just released report, it says many countries are implementing climate change policies. But the PC did not examine Australia's mining competitors. And in those countries it did examine, the policies adopted are often ineffectual and inefficient. Moreover, those countries generally exempt their trade-exposed, carbon-intensive industries from paying for carbon emissions. By imposing a carbon tax on those industries, we would truly be flying alone. The government's response to this involves six arguments that are individually incorrect and collectively incoherent.

First, it asserts, contrary to all evidence, that the world is on track to achieve credible, enforceable agreement on reducing carbon emissions.

Second, it argues that whatever the difficulties, action by Australia would significantly speed global agreement.

However, even if the scheme did advance global agreement, the question is whether there are not cheaper options for achieving that goal. Spending even a tiny fraction of the policy's cost scaling up our participation in the global process would surely be every bit as effective in advancing international agreement. And if those efforts failed, we would not be left with a costly scheme entrenched by constituencies with an interest in its perpetuation.

Third, the government says its proposal would reduce uncertainty and promote investment, notably in electricity generation. Uncertainty about carbon prices does create issues for electric power investment. But that uncertainty is inevitable given the absence of international agreement. Trying to deal with it by imposing needless costs on the economy as a whole is neither sensible nor sustainable. And the government's scheme, with its multiple decision points and timeframes, only adds risks to those investors already bear.

The government's fourth tack is to cast the issue as a matter of morality. Of course, appealing to our better instincts sits uncomfortably with the government's mantra that it won't hurt a bit. But, even putting that aside, there is nothing particularly ethical about wasting resources. Nor is it especially noble to squander them on climate change.

Fifth, the government argues that without an ETS, other countries will impose punitive tariffs on our exports. Whether that would be legal is questionable. It overlooks the fact those countries are exempting their exports from carbon imposts, making it implausible any claim against us could succeed. Even more importantly, it makes no sense: if Germany taxed imports of our low-cost ores, its industries, not ours, would mainly suffer, losing sales to competitors that did not impose such taxes. Not even the Europeans are that irrational. Even were there a risk that they are, trashing a year's national income is surely not the most cost-effective insurance policy.

Sixth and last, the government says an ETS is more economically efficient than the alternatives. True, the wealth transfers that masquerade as climate policy are an insult to common sense. But the government is not intending to eliminate those schemes: indeed, its modelling has assumed they would stay in place. And the government and Ross Garnaut propose adding new wealth transfers, compounding the waste. Even were a completely clean-skin ETS preferable to what we have now, that is irrelevant to evaluating what is actually on offer. Rather, if government is sincere about enhancing efficiency, let it release modelling comparing its proposal, including the existing and proposed handouts, to the wait-and-see option and to the schemes proposed by Warwick McKibbin and Geoff Carmody. Let it, in other words, address the issue of policy relevance: given global uncertainties, how does adopting this scheme compare with alternatives, including that of eliminating the wasteful policies currently in place?

That would be to answer the intelligent question. If it refuses to tackle that question, the government will doom the Treasury's modelling, no matter how competent it may be, to ultimate irrelevance.