The Australian

Unilateral action creates costs without benefits

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An illustration by Bill Leak.
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"HAWKE and Keating floated the dollar; we will price carbon," Julia Gillard said just prior to last week's deal with the Greens.

The comparison is inaccurate, however, for floating the dollar, like cutting tariffs, was desirable even if Australia acted alone; in contrast, a carbon tax can only yield benefits if major emitting countries do the same.

Moreover, the Hawke-Keating reforms, including floating the dollar and reducing protection, enhanced our long-standing comparative advantage, which is based on our resource wealth. So did those of the Howard government. This policy undermines it.

Indeed, in terms of Australia's national interest, it is difficult to think of a policy more harmful than such a unilateral tax.

This is because a high share of Australia's emissions are accounted for by export-oriented activities: some 33 per cent, compared with 8 per cent for the US. These activities include mining, where large fugitive emissions occur as resources are extracted.

Given the ready availability of alternative sources of supply, including Canada, the US and Brazil, a unilateral tax on these exports cannot cut global emissions: it merely alters their location.

But it would reduce Australian incomes, transferring overseas gains we would otherwise obtain from the resources boom. This policy therefore imposes costs without any obvious benefits.

In its defence, supporters of unilateral action make four claims. None of these stands up to scrutiny. The first is to deny our tax would be unilateral, pointing to carbon abatement policies elsewhere, notably Europe.

In reality, those policies are costly and ineffectual: the abatement they secure could be obtained by a carbon price well below that envisaged here. But even putting that aside, our export industries do not compete with the European economies. So whatever their carbon policies may be, they do not make our action any less unilateral in its consequences.

The second claim is that even if unilateral action did cause income losses, the creation of green jobs would offset them. The whole notion of a green job is confused: jobs are no more colour-coded than are people. And it is even more confused to think low-emission jobs are inherently preferable to those that are emissions-intensive: rather, what matters is each activity's contribution to wealth creation, assessed taking proper account of the social cost of emissions.

The extent of that wealth creation does not depend on whether a job is green, blue or purple; it depends on opportunity costs, that is, on what society gives up to generate a dollar of output in that activity. A well-functioning economy specialises in those activities in which its opportunity costs are lowest: that is what specialisation in line with comparative advantage means. Because we are so abundantly endowed with natural resources, Australia's opportunity costs are especially low in mining. That is why our share of world mineral exports is more than 25 times greater than our share of world exports overall.

And it is that specialisation in line with comparative advantage that makes us well off, as it allows us to import the many goods in which we have a comparative disadvantage from wherever their costs of production are lowest.

Given how pronounced our comparative advantage is in mining, shifting resources to other activities must make us substantially poorer. The claim that jobs tending windmills or speculating on emissions permits could offset those losses is implausible.

It is especially implausible as our pattern of comparative advantage is becoming more pronounced: in the nine years from June 2000, the net present value of Australia's mineral assets more than trebled. With the world placing ever higher value on our natural resources, relative to our other factor endowments (such as capital and labour), the income loss from unilaterally taxing mining exports must rise.

That loss is all the greater because the carbon tax acts like a supplementary royalty, as the amount to be paid rises with volumes produced. It therefore compounds the distorting effect of existing royalties and of the new mining tax. How the government can stridently criticise mining royalties because they tax production but want to aggravate their impact is yet to be explained.

The third claim defenders of the tax make is that by acting now, we increase the prospects of global agreement. That claim is also implausible. It accords Australia an influence at odds with the experience of international negotiations, not least at Copenhagen. Additionally and importantly, it ignores the fact that by undermining our own exports we make preventing agreement even more profitable for our rivals.

That the government has no plan for repealing the tax should international agreement not eventuate in a set time frame makes our rivals' incentive to delay even greater. To believe altruism will trump self-interest in determining their negotiating stance involves a considerable leap of faith. Fourth and last, supporters of a unilateral carbon tax claim it will bring certainty.

However, the only certainty for the community as a whole is that incomes will fall. What is left uncertain is just how great that fall will be, as that depends on what happens when the time comes to shift from a fixed carbon tax to a scheme based on emissions permits.

It is, for example, widely rumoured that the carbon tax will be around $20, increasing annually by 4 or 5 per cent more than inflation. Given that starting point, were the government, at the end of the three year period, to set the number of permits so as to cut emissions in 2020 to 15 per cent below 2000 levels, the implied carbon price would treble, causing enormous dislocations.

The government knows that; little wonder it is determined to postpone those decisions to a later date. But far from providing certainty, thus multiplying decision points, with fuzzy decision criteria at each juncture, compounds uncertainties and invites rent-seeking. Finally, would these problems be ameliorated were the tax only on domestic consumption, exempting exports but taxing imports, as Geoff Carmody has proposed?

Of course they would. But that is only because we are acting unilaterally, damaging our exports. Shifting the burden on to domestic consumption reduces the harm. But the harm does not go away: it is just diminished. The question remains, therefore, why we would act unilaterally, creating costs for so few environmental benefits. To that question, the community still awaits a sensible answer.