

# **AUSTRALIA'S CARBON PRICE: GOOD POLICY OR NOT?**

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Crawford School Dialogue  
Monday 5 September, 2011

# Global climate change is a global problem

- Without credible global action, unilateral action by Australia is pointless....
- And extremely costly:

Tax	Average Excess Burden
Carbon tax	
Treasury modeling	2.0
Unilateral action	8.0~12.0
Mining royalties and crude oil excise	0.7
Insurance taxes	0.7
Payroll tax	0.4
Corporate income tax	0.4
Labour income tax	0.2
GST	0.1

***As a result, we should “wait and see”***

# Criticisms

1. **Despite lack of global agreement, the rest of the world is acting**
  - a) Yes, but falls far short of what is needed and even then is uncertain .. and is accompanied by many subsidies to emissions
  - b) We are likely to see more costly but ineffective abatement measures, pandering to coalitions of 'green' rent-seekers and environmentalists
  - c) **But the same global forces that have caused the slow death of the Doha round will impede effective action on climate change**

# Criticisms

2. **If we act, it will encourage the rest of the world to follow**
  - a) Implausible on its face: our trade liberalization in recent decades had no effect on international outcomes
  - b) Is contrary to the logic of free-riding
  - c) Even if there were some such effect, it would likely be small relative to costs and risks
  - d) **There are likely to be more cost-effective ways of advancing international agreement**

# Criticisms

## 3. It is cheaper to act now than later

- a) Inconsistent with Treasury's own modeling, which finds meeting the objective beginning now is lower cost than doing so at the time of CPRS
- b) The efficient rate of mitigation,  $z$ , grows over time according to
$$dz/dt = ((r + a)/\gamma(z))/z(t),$$
where  $r$  is the risk-adjusted discount rate,  $a$  is the rate of technical progress in mitigation and  $\gamma(z)$  is the elasticity of mitigation costs with respect to the amount of mitigation (the inverse supply elasticity). If  $a$  is large and  $\gamma(z)$  low, it is efficient to postpone mitigation
- c) Even more important, **if it is very costly to dismantle the scheme once it has been implemented**, then it is wise to wait

# Criticisms

4. **We need a carbon tax to reduce the uncertainties bearing on investors**
  - a) Those uncertainties are a fact of life, inherent in the current global situation – **introducing a carbon tax does not reduce the uncertainties, it merely shifts them on to the Australian community**
  - b) It is by no means obvious that the Australian community is **the least cost bearer of those risks** – i.e. can bear them at lower cost than international capital markets and electricity consumers
  - c) Indeed, if international markets can spread those risks across countries, they may bear them more cheaply
  - d) But even if the Australian community were the least cost bearer of say the climate-change related risks associated with investment in base load power generation, **there are likely to be more cost-effective ways of managing those risks than implementing an economy wide carbon tax**

# Criticisms

5. **We are in any event committed to a 5% abatement target and a carbon tax is the most efficient way of achieving it**
  - a) We should be willing to reconsider the target given the uncertainties surrounding the international context – unilateral abatement is futile
  - b) But even if the target is retained, it is by no means obvious a carbon tax is the most efficient way of achieving it
  - c) For example, such a tax could be efficient if it was a substitute for more distorting measures
  - d) But **an important effect of the revenues raised by the tax is to reduce the opportunity cost to government of making concessions to environmental rent-seekers**
  - e) It is therefore no surprise that far from abandoning “direct action”, the Gillard government proposes to greatly scale it up
  - f) But basic economics shows that **like turning up the volume on a faulty amplifier, adding a tax to other distorting interventions more often makes things worse than better**
  - g) And if the tax leads to the other distortions being scaled up, then outcomes are worse again

# Criticisms

6. Treasury's modelling shows the costs are low, so we should adopt the carbon tax as a form of insurance
  - a) Treasury modeled the scenario in which the rest of the world adopts such a scheme and we do too; and the somewhat irrelevant case in which the rest of the world acts and we do not. **But it has not modelled, or if it has modelled has not released, the scenario in which we impose such a scheme and our major competitors do not**
  - b) Even so, ***at one year's GDP, Treasury's estimate of the costs is anything but low***
  - c) Treating those costs as a form of insurance makes no sense: insurance transfers income from states of the world where its marginal utility is low to those where it is high, while this does the opposite – technically, **this is anti-insurance: it increases our exposure to risk**



**Other than the government's political convenience, there are few cogent arguments for proceeding now**