# Who gains most from axing the carbon tax – and at what cost?

July 18 2014, by Stephen King

When the carbon tax was introduced, there was a lot of discussion about winners and losers. The Labor government limited the number of businesses that had to pay the tax, while it also gave carbon tax relief to large carbon emitters and large energy users. There were tax cuts for households to shield them from the effects of the carbon tax.

The aim was to make the relative price of carbon intensive industries higher, not to arbitrarily benefit or hurt particular groups. In economic terms, the carbon tax aimed to create "substitution effects" away from carbon intensive industries while compensating people for the "income effects" of the tax.

This was sound economics. But all that has been forgotten in the drawn-out negotiations over the carbon tax repeal, which finally passed the Senate on Thursday morning.

The current debate has focused mostly on ensuring that the savings from the carbon tax are passed through to households. While the size of those savings is disputed, the idea that the future compensation to households should also be removed was quickly scotched by the Senate.

Households look set to have their cake and eat it too. They will get savings due to the removal of the carbon tax, while being compensated for a carbon tax that no longer exists! Of course, this will just expand the government's budget black hole and lead to tax hikes and/or spending cuts down the track – which means that households win in the short-term

will come at a higher cost later.

## Brown coal's revival

Who else wins in the short-term from the removal of the carbon tax?

Clearly the big greenhouse gas emitting electricity generators win. In particular, the brown coal generators in Victoria's Latrobe Valley will again become the cheapest (and still the dirtiest) electricity generators in the country. This simply reflects the nature of brown coal and the fact that it has few uses other than power production close to where it is mined.

Brown coal has a high moisture content. This makes it expensive to transport before it is dried. After all, you are transporting a lot of water.

Unfortunately, after it is dried brown coal becomes volatile, which also makes it uneconomic to transport. So brown coal is dried near the mine and then burned to produce cheap electricity. But both the drying process and the burning create significant greenhouse gas emissions.

Under an effective carbon tax, brown coal generators would be the first to close. The fact that high-pollution Hazelwood power plant continued to operate even with the carbon tax leads to real questions about the original policy's effectiveness.

With the removal of the carbon tax, Victoria's brown coal generators and the Latrobe Valley in general face less immediate upheaval.

Large greenhouse gas emitters can also win through the government's direct action policy. This policy will seek projects to reduce emissions and will accept those projects which reduce emissions at the lowest bid cost. If you're a major greenhouse emitter, then given the choice

between getting taxpayer-funding to stop your pollution, or being taxed for that pollution, it's fairly obvious which one you'd prefer. Of course, this just means more budget pain as the government turns a revenue source for the government into a new pool of government spending.

## The biggest losers

Who loses from the carbon tax malaise in Australia? If Australia does not have a clear strategy to deal with climate change, then I would argue that we will all lose. But the problem is wider than just Australia's self-interest.

Global warming – as the name suggests – is a global issue. Australia is a large emitter of greenhouse gases on a per person basis. But, because we are a small economy, our total emmissions are relatively small on global terms. We could pay to offset and eliminate our greenhouse gas emissions tomorrow. But, other than making us feel morally superior, it would have little direct effect on global climate change.

Our policies could have an indirect global effect. By showing the world what we could do, Australia could give other countries an example to follow in acting more decisively on greenhouse emissions. This was the best argument for the carbon tax and, longer-term, for an Australian emissions trading system.

Unfortunately, the Senate debacle of the last two weeks and the imminent scrapping of the carbon tax hasn't helped Australia's international reputation as a nation doing our fair share to tackle climate change.

## What next for Australia and the world?

So assuming the carbon tax is scrapped, what should we do next?

In my opinion, Australia should be actively engaged in the global debate about how to develop and pay for technology to deal with global warming.

This will not involve growth-reducing strategies that limit pollution in China, India or Africa. These regions will continue to grow their economies as rapidly as possible to move millions of people out of desperate poverty. But if that involves the development of high-polluting industries, then we will all have to face and pay for the global impacts of more severe climate change.

That leaves the developed world in the situation where it should be encouraging research into how to generate energy cleanly and how to mitigate the ongoing damage that global warming will create over the rest of this century. There are pathways to growth with low carbon emissions, but as Anna Skarbek and Frank Jotzo note:

some key technologies that are critical for deep decarbonisation in all countries' pathways are not yet technically mature or economically competitive.

Economic incentives for innovation may be direct, including through direct action-style payments. They may also be indirect, through taxes and other mechanisms that penalise high emitters and reward those who develop low-polluting substitutes.

This may all sound overly optimistic. But in my opinion it is simply realistic. The developed world cannot ignore either the needs or the reality of millions of people living in poverty. Poor nations will adopt economic policies to grow richer. If the governments of those countries do not promote development then they are likely to be overthrown,

either at the ballot box or through force. So climate solutions that restrict poor country growth, in my opinion, are simply unrealistic.

For the developed world, the alternatives are clear. We can do nothing – or limit our ambitions only to cutting emissions within our own borders – and watch as global emissions continue to soar from China and India. Or we can promote innovation to both adapt to climate change and to reduce greenhouse gas emissions.

Economics can help create the right incentives for this innovation. But the climate "deniers" are not just those who deny the science; they also include those who deny the economics and focus too much on cutting Australia's pollution, as if that alone is a solution. It is not.

It's not enough to think global and act local, as the old environmentalists' slogan goes. We need to think global – and act global too.



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