

Bring Back the Carbon Tax?

Mr Hockey has invited the Australian public to join in a conversation about the economy and budget issues. Here is my mildly radical contribution.

There are two strong reasons for bringing back the carbon tax.

Tony Abbott, when Leader of the Opposition, promised to repeal the carbon tax brought in by Prime Minister Julie Gillard. And he has fulfilled his promise. Congratulations. Now circumstances have changed: the budget deficit and public debt have turned out to be important problems in the eyes of the Government because of the somewhat unexpected decline in export prices. So Mr. Abbott or his successor as Prime Minister would be justified in re-imposing this tax. This is the first reason: *the revenue from a carbon tax could make a significant contribution to dealing with the deficit problem.* Of course, it would not be enough, and, as is well known, other measures or reforms to generate revenue for the government are available and are certainly needed.

The second reason for restoring the carbon tax I shall discuss later. First, let us take a closer look at this tax, both as a burden and as a revenue raiser.

The Carbon Tax as a Burden

Mr Abbott certainly convinced his fellow Australians that this tax would be a burden. So, I have taken a close look at his two key speeches, one in September 2011 when the bill to launch the tax was

before Parliament and the other in July 2014 when the tax was repealed.

In his view this was “just another big new tax.” But one could add that all taxes impose burdens or costs somewhere, whether on companies or individuals. One might reflect that, in current circumstances, because of the budget problem, a “big new tax,” and perhaps more than one, is just what doctor Hockey ordered.

The carbon tax was paid by numerous businesses, but this did not mean that they carried the final “burden”. Mostly they would have passed it on to their customers, both households and businesses. Essentially it might be regarded as a fossil energy tax. When the tax was repealed Mr Abbott stated that households would benefit on average by \$ 550 a year, with gas prices to fall by 7% and electricity prices by 9%. His much-repeated and persuasive message was that the carbon tax raised the cost of living and this was “toxic” and “has been hurting ordinary people”. I suspect that his strong opposition to the tax was influenced more by the complaints of producers of emissions-intensive products – especially in the coal industry – than by complaints from average citizens. He also argued that a tax that raised energy prices would have led to job losses.

All this seemed very persuasive. The persuasion was reinforced by the fact that earlier – essentially from 2007 to 2010 - electricity prices had risen sharply for other reasons, essentially to pay for the high costs of excessive investment in networks (poles and wires). In many minds those price rises were mixed up with the expected effect of the carbon tax.

Where did the Revenue go?

Now, there is something very odd. In his two speeches Mr Abbott never refers to the government revenue that was raised because of the carbon tax. Did the tax not have any beneficial effects for households or businesses to compensate for the directly adverse effects of the higher prices of energy? Where did this revenue go?

In fact, some of it was used to compensate firms that competed in international markets while a substantial part compensated low income households through reductions in their income tax. The latter was an important element of the Gillard programme. What was taken out of the income stream by the carbon tax at one point was put back by the compensation at another point. If there were job losses at one end, there would be job gains at the other. Furthermore, reducing income tax, at least in the low income ranges, would increase the incentives to seek work, a highly desirable economic effect. Possibly some of the revenue led to greater government spending which benefited households. By ignoring all these offsetting revenue effects Mr Abbott was able to conclude that the carbon tax had a severely adverse effect on incomes and employment. Did he really believe this?

At this point one might ask: what was the point of the whole exercise when funds are taken out of the economy at one end and put back at the other. The answer seems obvious. The carbon tax would produce market inducements that reduced harmful emissions of greenhouse gases. Of course, if one does not believe that climate change is a problem, or that Australia could make any difference, the whole business seems pointless. And if one assumes that nothing happens to the revenue, the tax would seem not just pointless but harmful.

Use the Revenue to reduce the Deficit?

Let me come back to my proposal that the carbon tax be reinstated. This time the whole of the gross revenue might be used to reduce the budget deficit. It would not finance increased government spending. How much money would be available? According to official estimates, in the first two years of operation the carbon tax raised \$15.4 billion in gross revenue

If the carbon tax revenue actually reduces the budget deficit without compensating tax or spending changes elsewhere the benefit would then be in the future (when debt is lower than otherwise) while the return of the “big new tax” would indeed impose a present cost. Mr Hockey would then get his deeply desired budget improvement and Mr Abbott could keep on complaining about the big new tax.

But Mr Hockey would have to think about the current macroeconomic implications of improving the budget balance through higher taxes, possibly combined with reduced government spending. This would reduce total national spending (aggregate demand) and thus increase unemployment. In that case one would hope that the Reserve Bank of Australia would compensate by stimulating the economy through monetary policy, which in turn would induce depreciation of the exchange rate and thus make Australian industries more internationally competitive.

Why Climate Change Matters

Climate change is a world problem. Those who believe that it is not really a problem are unlikely to be reading *The Conversation*, but if by strange chance they are among my readers, they should stop here. But, also, there are “realists” who do not deny climate change but who argue that Australia generates such a small proportion of the world’s harmful carbon emissions that we cannot make any difference anyway. So, why bother about a carbon tax? Here I wish

to go beyond this view. *We can make a difference, and, above all, it is in our interest that we do.* The basic point is that we may not be able to directly affect world climate on our own, but it certainly will affect us, so we must try and affect the future world climate through influencing collective action among many countries.

We would be affected adversely by climate change, and possibly are already. This effect could be severe. Therefore we should certainly try to make a difference.

How would we be adversely affected?

(a) First there is the direct effect on Australia, and especially its coastline. All the details can be obtained from CSIRO documents. Likely effects include reduced rainfall in southern Australia, more extreme fire weather, adverse effects on the Great Barrier Reef, on coastal populations, and so on. Particularly important for Australia are increasing heatwaves. (Heatwaves have killed more Australians than all other natural hazards combined).

Apparently we would be more adversely affected than any other developed country. In view of this, it is just amazing that our government has such a sceptical attitude to climate change compared to governments of many other countries.

(b) Second, there is an important effect perhaps neglected by an inward-looking population. The rise of the sea level in association with severe weather events is likely to have a serious impact on islands and island countries. And there are many of these in our region, above all Indonesia with many of its population of 250 million people highly vulnerable, and, of course, the Pacific Islands. We may eventually have to cope with floods of climate refugees.

What we must do in our Interest: the second Reason for returning to the Carbon Tax

The moral is that for *selfish reasons* we need to use our maximum diplomatic influence to encourage other countries – and particularly the United States, but many others as well – to take the necessary measures to drastically moderate or avoid climate change. And we can only do this if we set an example ourselves. A restoration of the carbon tax would be the first step. Furthermore, our government should actively campaign for world-wide measures to mitigate or avoid climate change, and also finance appropriate research. In other words, *in the national interest* the government should completely reverse its current stance. Our current captain, no doubt well meaning, is steering the ship in the wrong direction.

The simple immediate measure would be our return to the carbon tax. Of course, eventually this might evolve into an Emissions Trading Scheme (ETS). In both cases carbon emissions will be discouraged and the government will receive revenue.

A very readable explanation of all the issues is in Ross Garnaut, *The Garnaut Review 2011: Australia in the Global Response to Climate Change*, Cambridge University Press 2011. See also John Quiggin et al, *Carbon Pricing: Early Experience and Future Prospects*, Edward Elgar, 2014, and John Freebairn, “ Carbon Price versus Subsidies to Reduce Greenhouse Gas Emissions,” *Economic Papers*, vol. 33, September 2014, pp 233-42.