Carbon tax will light a slow fuse

Economics & Deregulation, Deregulation Unit and Climate Change | Alan Moran
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A form of carbon tax such as the emissions trading scheme cannot reduce global emissions unless there is agreement for a similar level of tax across all economies. That aside, the government's immediate issues are how to spend the money the tax raises, including how to avoid compensating the privatised brown coal generators for losses the tax causes.

Naturally, to ensure re-election, the Rudd government wants as much of the revenue as possible to go to voters. But the government is constrained because the tax would cripple firms that are unable to pass on all its costs. Twenty-five per cent to 35 per cent of the revenues raised are, therefore, to flow to the emissions-intensive, trade-exposed industries. This has kept those firms quiet by cushioning the effects of the carbon tax on their existing assets.

That the carbon tax means nobody will again build an aluminium smelter, a steelworks or any other facility that makes use of Australian low-cost energy is not their worry. Nor, apparently, is it a concern of governments, all of which seem to envisage a dreamy, new low-energy economy that jettisons domestic consumption of our coal reserves and, eventually, our gas reserves.

Other business users also will be losers from the higher priced electricity brought about by the ETS tax. Higher energy costs will undermine the profits of all firms and even destroy some businesses. But the damage to relatively low energy users will be less easily traced to the government imposition.

The other major loser industry comprises carbon-based electricity producers. These provide 85 per cent of Australia's electricity. The ETS tax hits the brown coal generators hardest, followed by black coal generators. Notwithstanding the government's fantasy about new low-cost power generation technologies emerging, there is no alternative to the present supply profile, so it's more than likely we will see few generator departures.

Indeed, the compensation offered to the coal power stations is contingent on them remaining online when the only way the government can meet its stated carbon reduction goals is if they close down.

That aside, as with energy-intensive industries, the government has made it impossible for any firm to again build a base load power station in Australia without giving it a cast-iron carbon tax indemnification. As with the energy-intensive industries, the proposed tax will impose substantial costs on the existing generators. The most vulnerable are Victoria's privately owned brown coal generators.

Though Canberra refuses to publish its own estimates of the cost to the generators' shareholders, these are unlikely to differ from the $8billion to $10bn estimated by commissioned studies for the Victorian government and for the generators themselves.

Canberra is keen to avoid paying these costs to businesses it has already demonised as producing dirty energy. Its process has been to play the tough cop, soft cop game. The tough cop, Labor's consultant Ross Garnaut, argued that the generators should get no compensation on the (incorrect) basis that there was no tradition for such provision in Australia. Uncharacteristically, Climate Change Minister Penny Wong played the soft cop and offered $3.5bn in compensation.

The Coalition is arguing for $10bn in compensation, though an unknown amount of that is to go to the state-owned black coal generators in NSW and Queensland.

The issues are perceptions of ``sovereign risk'' on all future foreign investment and whether a hardline approach will mean distress sales and low maintenance causing power outages. The latter is an open question but has belatedly

become a concern of the Brumby government since brown coal provides 96 per cent of Victoria's supplies.

With regard to sovereign risk, it is argued that the investors bought these facilities more than five years after the 1990 Kyoto Protocol writing was on the wall, and any business risk of expropriation by regulatory taxation should have been built into their decision frameworks.

The generators would maintain that the state government sales documents contained no indication that a future government would impose a new discriminatory tax on the assets being sold, thereby reducing their value.

Nor did the opposition at the time indicate such likelihood.

If the sale was by a private enterprise that withheld information about the imposition of post-sale measures, that would significantly devalue the assets and the buyers would have legal recourse.

In fact, the generators have a better case to be compensated than emission-intensive industries, at least those built or bought in the past 15 years, since the emission-intensive industries were not bought from the government, a related branch of which is now imposing a discriminatory tax on them.

This haggling over compensation is vital to present investors and of concern also to the government, which could see some depletion of its election-buying pot of new taxes.

For the Australian economy the stakes are far greater.

The planned carbon tax regime (and opposition to nuclear generation) makes significant new power plant investment impossible. This lights a slow fuse under the economy's growth potential.

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