

Greenhouse guess: tax vs. trade

[Climate Change](#) | [Alan Moran](#)

ABC Unleashed 2nd March, 2009



Politicians have converted the global warming policy chess match into a poker game with a constantly revised bidding currency, comprising tradable emission rights, carbon taxes and a range of other measures.

Carbon taxes, and tradable rights to emit carbon, like the proposed Emissions Trading Scheme (ETS), are known as "economic instruments". To minimise the costs of reducing emissions, economic instruments apply a market based approach. This provides firms and individuals the incentives to ensure targeted reductions are achieved at least cost in contrast to more common regulatory approaches which specify selected controls.

Penny Wong argues that carbon taxes are intrinsically inferior to a cap and trade based Emissions Trading Scheme (ETS) because an ETS offers certainty in terms of quantitative emissions. But in doing so, it brings a volatile and unpredictable carbon price. By contrast, a carbon tax, if fixed in advance, sacrifices quantitative certainty for price stability.

The Greens' Christine Milne gets this, though the Greens' policy muddies this purity by also seeking additional regulations like bans on coal, and targets for renewables and energy efficiency. Ms Wong also departs from an economic instruments approach, for example with her promotion of the \$3.9 billion subsidy to insulation and solar hot water heaters. Presumably she considers these to be part of the fabled "low hanging fruit" to which market but not government wisdom is blinded. Yet, various independent estimates have demonstrated such measures to be very high cost. The former Liberal Government's countless regulatory measures, including the centrepiece mandatory renewable scheme, are testimony to their own lack of consistency.

Because we cannot be certain about the reaction of price to quantitative restrictions, price and quantitative certainty cannot both be set simultaneously. Any quantitative or price target must inevitably be modified in the light of experience of the interactions.

For example, the mooted reduction in Australian emissions by five per cent is estimated to require a carbon tax of \$20 per tonne. The target and the price represent policy formulated on a cost/abatement trade-off. But if it turned out that a \$100 per tonne tax was required, surely the target would be varied; if the price outcome for achieving the target turned out to be only \$1 per tonne we might opt for considerably more mitigation.

Similarly, under a tax based approach, the tax rate would be modified and the quantitative target revised in the light of market experience. Soundly based public policy must operate with both a price and quantitative target. Uncertainty about the interaction of quantity and price rules out an inflexible policy setting.

Ostensibly, a tax based approach offers administrative cost economies but only if each component of a product has a carbon intensity certification, to allow a GST form of tax. This would involve some border duty approach together with netting back the tax paid on exports but it would remain extremely complicated to design and monitor.

Equally problematical is the treatment of the energy intensive industries under an ETS. The White Paper envisages a new bureaucracy determining some global level of disadvantage for Australia with firms and industries compensated accordingly. However, the disadvantage will differ markedly between different sources and across dozens, perhaps thousands of product classifications.

Ms Wong argues that one advantage of an ETS is that it allows Australia to tap into international trades in carbon credits. But the costs of this, which Treasury estimates at \$26 billion a year by 2050, are no different from those involved with a tax which a profitable line of business can simply pay.

The Commonwealth's ETS policy proposals are underpinned by Treasury's forecasts of abatement and price relationships. These embody some highly optimistic projections of as yet untested and even barely imagined mitigatory technologies. Treasury's decarbonisation forecasts might be more achievable if Australia were to fully adopt nuclear power, though this would entail the scrapping of all coal and gas electricity generators and considerable change in motor vehicle technology.

One key outcome of the Treasury modelling offers a particularly promising policy approach. This is the Treasury estimate of the costs of doing nothing to 2020 and then catching up with the 2050 target thereafter should the need and achievability of such action prove necessary. That cost is put at 0.3 per cent of GDP by 2050.

Even if this is not overstated, 0.3 per cent of GDP seems a reasonable insurance policy price to pay rather than imminently embarking on measures that will be in the White Paper's words, "the most significant structural reform of the economy since the 1980s". By 2020 we will be clearer on the need for emission reduction policies and will, presumably, have access to all the technological advances that Treasury claim will be forthcoming.

The appropriate policy response therefore is to prepare an emission reductions plan that would become operational if the science becomes more certain and if the world has developed a consensus to abate. In the interim, given the relatively low cost of maintaining business-as-usual for the next decade, we should avoid incurring the expenses of such action.

[Back to news page](#)



[Become a member of IPA today](#)

Archived news

[2014](#)

- > [August](#)
- > [July](#)
- > [June](#)
- > [May](#)
- > [April](#)
- > [March](#)
- > [February](#)
- > [January](#)

[2013](#)

- > [December](#)
- > [November](#)
- > [October](#)
- > [September](#)
- > [August](#)
- > [July](#)
- > [June](#)
- > [May](#)
- > [April](#)

- > [March](#)
- > [February](#)
- > [January](#)

[2012](#)

- > [December](#)
- > [November](#)
- > [October](#)
- > [September](#)
- > [August](#)
- > [July](#)
- > [June](#)
- > [May](#)
- > [April](#)
- > [March](#)
- > [February](#)
- > [January](#)

[2011](#)

[2010](#)

[2009](#)

[2008](#)

[2007](#)

[2006](#)

[2005](#)

[2004](#)

[2003](#)

[2002](#)

[2001](#)

[2000](#)

[1999](#)

[1998](#)

[1997](#)

[1996](#)

[IPA](#)

- [Home](#)
- [About](#)
- [Key Sectors](#)
- [News](#)
- [Events](#)
- [Publications](#)
- [IPA People](#)
- [Contact us](#)
- [Site Help](#)
- [Payment](#)

[News](#)

Useful links

- [Top of page:: Site help](#)
- :: [Site map](#)
- :: [Privacy](#)
- :: [Copyright](#)
- :: [Subscribe to IPA email updates](#)

:: [Unsubscribe](#)