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Emissions confusion: trading vs taxes

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Some dramatic shifts in Australian political positions on climate change policy seemed to happen over the last few days. Parliamentary enquiries into the merits of emissions trading were initiated then extinguished only to be revived by the other side of politics, and confusion reigned over who supports an emissions tax over emissions trading. Some on the left as well as the right argued that emissions trading should be ditched in favour of a carbon tax. For example, the Australia Institute's Richard Denniss [claims](#) that an emissions tax is better for the environment because under emissions trading individual action to reduce greenhouse gases is futile. Meanwhile John Humphreys at the Centre for Independent Studies [says](#) that a tax is better for business than trading.

Can both be right, and do they in fact agree? No and no, and the reason is that the real arguments remain hidden.

The 'environmental' argument against emissions trading, also echoed in a recent [statement](#) by 'ten Australian economists', goes like this. An emissions trading scheme, like the government's Carbon Pollution Reduction Scheme, needs an overall quantity target for emissions. That target defines the outcome. So if you decide to cycle to work rather than drive, or you installs some solar panels, it simply means that someone else, say an industrial polluter, can emit more, paying a lower permit price. This is misleading, and in my view unnecessarily feeds into rising public frustration about climate policy.

The argument ignores that there is a national emissions target, like the 5, 15 or 25 per cent reduction targets. *That* is what will really determine Australia's contribution to the global effort to reduce emissions. So it is not a design fault of emissions trading or the government's particular scheme that extra voluntary action does not directly translate into lower national emissions. It is a consequence of having a national target.

Different domestic policy instruments can be used to meet the national target: emissions trading or an emissions tax to do the bulk of the work,

plus the renewable energy target, subsidies for new technologies and energy efficiency, regulations for industrial processes, and so forth. And if we still overshoot the national target (as may well happen) then Australia buys emissions offsets from developing countries.

Is 'voluntary' personal action to reduce energy use and emissions futile? Not at all. It is an integral part of achieving the overall outcome at least cost, and it will be encouraged by rising energy prices. The more we individually ditch our high-carbon habits, the easier it will be to collectively meet the national emissions target. That in turn will make it possible to go for more ambitious national targets down the track, as Penny Wong [pointed out](#). That of course requires that targets are actually ratcheted down if we find that they are easier to meet than anticipated, which remains to be seen.

Now for the business case for the emissions tax: a tax provides more certainty for business, because the tax rate is known in advance – in contrast to the emissions trading price which will arise in the market. If reducing emissions turns out to be easy, then emissions will be lower; if it's hard, higher. But this also ignores the national target. If the tax falls short of achieving the overall national emissions commitment, then more needs to be done through other policies, or more credits need to be bought from overseas, using taxpayers' money. Shifting uncertainty away from industry means imposing more uncertainty on the rest of the economy.

But can't we simply change our national emissions target in light of the emissions response to a carbon tax? No we cannot. The national target is and will be the core of Australia's international commitment on climate change. Much of the Australian discussion ignores this, and implicitly assumes we can reshape our international commitments. Warwick McKibbin, in his case for a hybrid system, [asks](#) "why lock in a target no matter what it costs, especially while the rest of the world is uncommitted to a clear policy?" Because like it or not, the world has chosen to a 'targets and timetables' approach to climate change mitigation. Clear policy and target commitments already exist in Europe, and are underway in America as well as Japan, and other countries are likely to follow. Australia could not overthrow the system even if that was the aim, but what Australia can do is help make the system work.

The debate about Australia's proper contribution to the global effort needs to focus squarely on the national emissions targets. What policy

instrument to use is a complex discussion, with arguments both ways, but it is not what determines the overall outcome. In any event, the debate of emissions trading versus taxes as the preferred domestic policy instrument has been had, not just in Australia in the 1990s but in many other countries. The verdict almost everywhere has been that it is the trading proposals that get implemented, never mind theoretical arguments in favour of taxes.

The lobby groups are not interested in the finer points of economic and administrative argument over taxes versus trading, but in who gets the money and how much is done. Suppose emissions trading gets dumped in favour of a tax. High emitting industries meanwhile will lobby for tax thresholds or tax exemptions, and for low tax rates. Tax thresholds would give much the same effect as free permits under trading, while tax exemptions would additionally introduce economic inefficiencies. Those keen on a rapid shift to a low-carbon economy and a favourable deal for households, will argue that under a tax there would be no exemptions and thresholds, plenty of revenue to recycle into green technologies, and a tax rate high enough to drive change.

So it is all back to basics: who foots the bill, where does the money go, and how much change is induced. These are questions that must be addressed regardless of whether the policy instrument of choice is an emissions tax or trading scheme. And they must be addressed with the long-term public interest at heart, without fear of change and without favour to large emitters.

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