

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

29 May – 31 May 2012

Question: BET 88

Topic: Efficiencies of Emissions Tax

Hansard Page: Wednesday 30 May 2012, page 28

Senator WATERS asked:

Senator WATERS:... Given the existence of the dead weight cost of taxation, is an approach that places a tax on emissions but reduces, say, income tax superior to one that increases some tax in order to pay polluters?

Dr Gruen: I think probably revenue group are the right people to talk to about the efficiencies of various taxes. We could give you an answer, but it would not be as finessed.

Senator Wong: Perhaps put it on notice now. If you can outline the questions, hopefully revenue group or someone is listening and they might be able to answer your questions.

Mr Ray: I did not get all of the question, but my sense is that probably the answer to your question is yes. But, if it is not, revenue group will give you chapter and verse.

Dr Gruen: They can give you a longer version.

Senator WATERS: I will take it up. I am interested in the longer version of 'yes'.

Answer:

The deadweight costs from taxation arise from distortions which move productive decisions away from before-tax optimal choices. For example, income taxes discourage work by reducing the after-tax wage. Calculations of deadweight loss should account for the presence of spillover effects ('externalities') where possible.

The deadweight costs of taxation are difficult to measure in absolute terms. Modelling by KPMG commissioned for the Australia's Future Tax Review (AFTS) suggests that, in respect of the relative deadweight costs of taxes, land tax, municipal rates and GST have low deadweight costs, labour income tax has a medium deadweight cost and corporate income tax has a high deadweight cost. These results are consistent with results from OECD studies.

For policy choices that maintain the same level of revenue, to evaluate the net benefits of a tax on emissions requires looking at its deadweight cost minus the deadweight cost of reduced taxes as a result of the new revenue. Likewise, evaluating direct subsidies requires considering the benefits of the subsidies (i.e. the benefits derived from reduced carbon emissions) minus the deadweight costs of taxation needed to raise revenue to pay for the subsidies.

The effectiveness of achieving the objective of reducing carbon emissions is also critical when comparing the two policy options. As a carbon price lets the market choose where emission reductions occur, it will deliver reductions at a lower cost per tonne of carbon dioxide than if the government chose where reductions occur through subsidies to reduce emissions. This means that for a given level of revenue (either from a carbon price or other taxation revenue), a market based

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mechanism will deliver more emission reductions than subsidies to reduce emissions. In addition, imposing a price on activities with significant externalities, like carbon emissions, helps to ensure that the market cost of the activities better reflects the social cost. This actually reduces the deadweight loss rather than creating new ones.

That is why in the 2010 Treasury Incoming Government Brief, the Treasury wrote *“the mitigation task to achieve your commitment to reduce national emissions to 5 per cent below 2000 levels by 2020 is significant. It cannot be achieved without a carbon price if damaging economic and budget impacts are to be avoided. Direct action initiatives alone will not do the job”*.