

# Comment: 'Environmental Taxation and its Possible Application in Australia' by John Freebairn

Harry Clarke

La Trobe University, June 2009

Australia's Future Tax and Transfer Policy Conference 2009

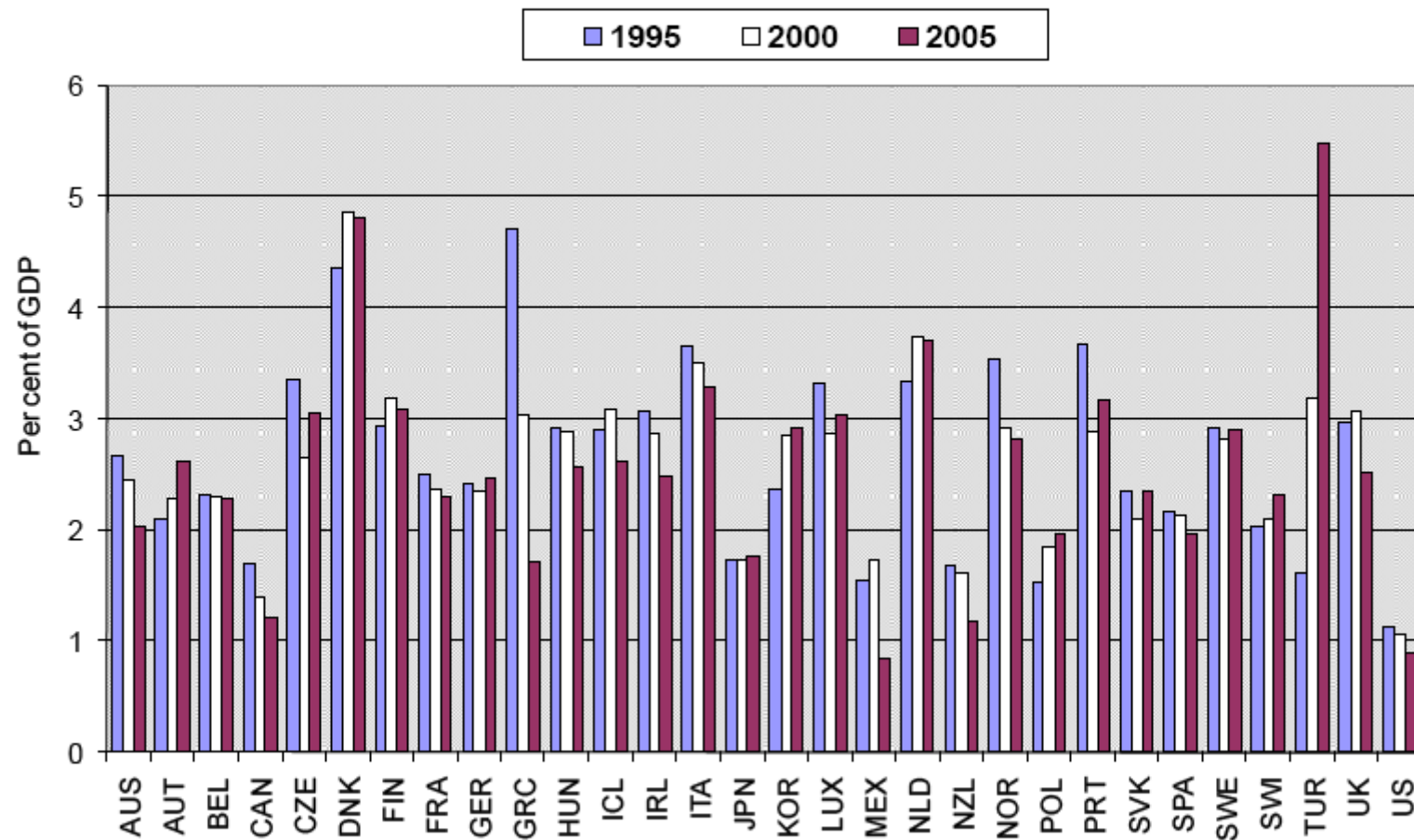


- John's report contains much deep economics expressed in straightforward way.
- This discussion a selective reflection of my interests.

# Quick synthesis

- Mainly oriented to the future as is the intent of the tax review.
- Environmental taxes not significant now in **any** OECD country.
- Clear from Chris Heady's paper.

Figure 10. Revenues from environmentally-related taxes in per cent of GDP



Note: 2005 data not available in the case of France and Iceland (2004 data used) and Korea (2003 data).

Source: OECD (2008a).

# Graph illustrates

- Across OECD environmental taxes are up to 5% of GDP - this is a lot - but 90% of these based on motor vehicle fuel & vehicle taxes.
- Australian environmental taxes were 2% of GDP in 2005 – a fall from 2.7% in 1995.
- The main ‘environmental tax’ is the (non-indexed) 38.143 cents/litre specific fuel excise.

# Fuel & vehicle registration charges

- Not mainly environmental taxes - a very crude way of pricing congestion, road damages or local pollution.
- In Australia differentiated rego charges recoup road damages but are **not** user charging.

# Can do much better than this on road pricing....

- Developments in *telematics* (vehicle boxes with communication abilities) are compelling.
- Have regulatory & commercial bases – can share a common platform.
- Can be used for congestion pricing, pricing by vehicle load, parking, distance-based-insurance, safety monitoring .....
- Technologically this can be done (almost) **now**.

# Summary

- Environmental taxes in Australia  $\ll$  1% of GDP.
- We estimate optimal tax on fuel at \$1.99/litre on basis of Parry-Small modelling of which only 44 cents reflect externality costs – the rest is (Ramsey) revenue-seeking.



# Interesting question....

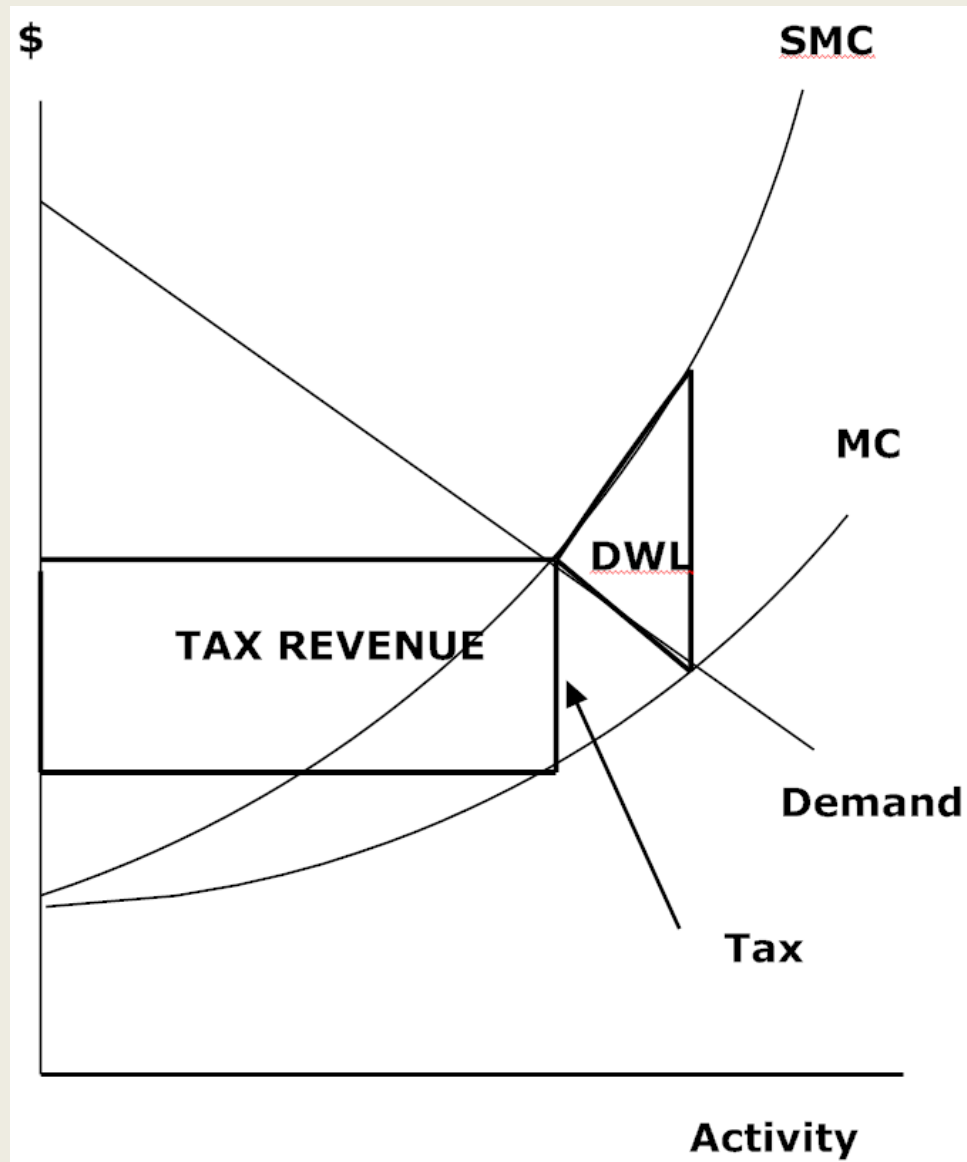
- Why are environmental taxes low given Australia's substantial urban congestion, waste disposal, water resource?
- We have high demands as a community for environmental quality.

# Tentative answer

- Widespread failure by industry to appreciate that environmental problems can be *addressed at lowest cost* using economic instruments such as taxes.

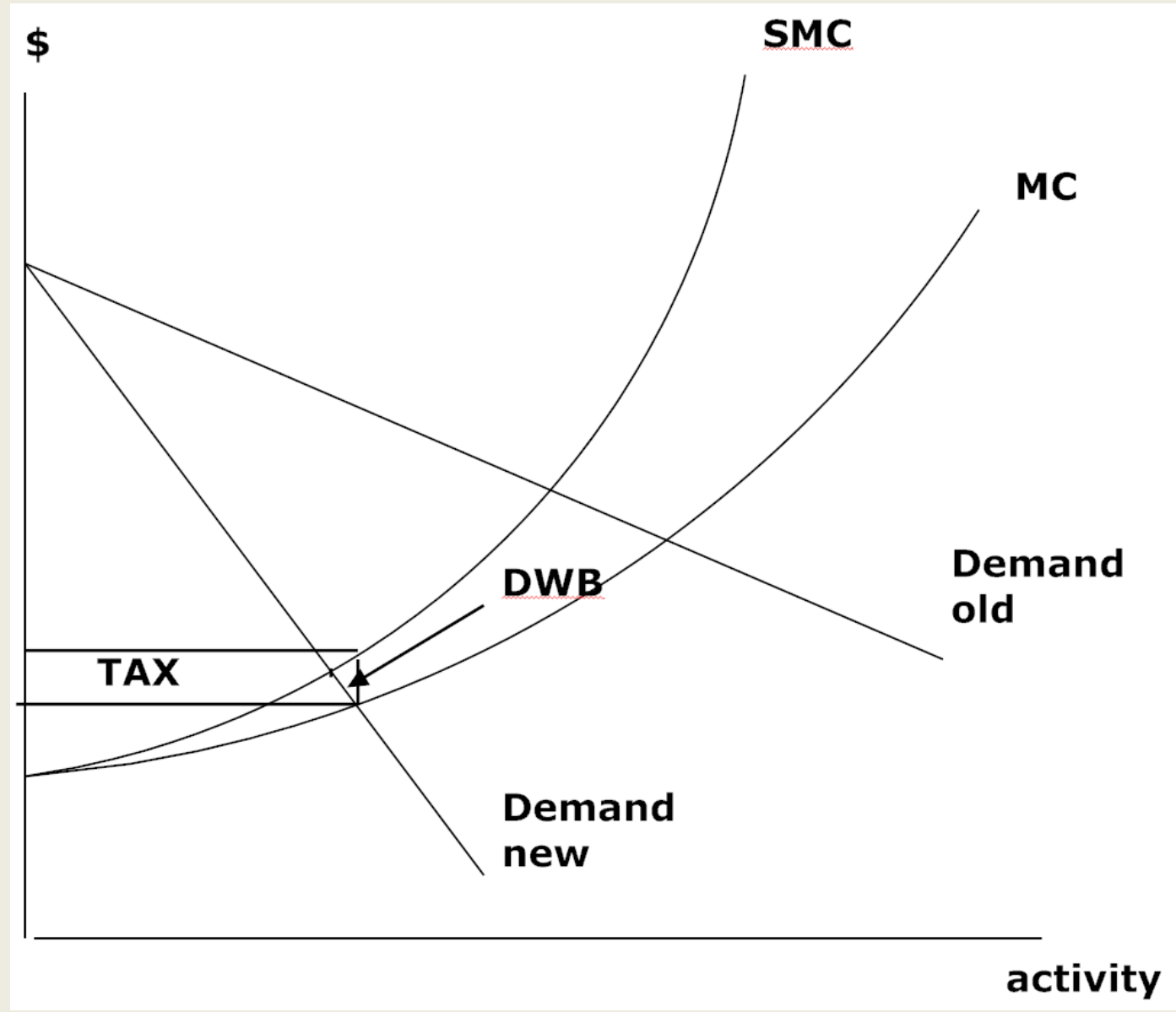
# The future:

- Can Australia secure a larger fraction of its taxes from environmental taxes? Should it?
- How **sustainable** are such tax yields?
- Significant potential bases are GGEs, water allocations & user charges in transport.



**Taxes don't approach zero when an externality internalised**

Tax bases might disappear with long-run demand reductions.



# Emissions Trading Scheme

- A major potentially-transforming tax if emission permits are sold competitively.
- Yield significant revenues sustainable in medium term. Base in 2006 was 576 million tons CO<sub>2</sub>E or 287 million tons from stationary energy sector.
- Revenues are being hypothecated to industry & consumer adjustment assistance to 'compensate' for energy price increases in short-run.

# Longer-term

- Sustainability of revenues as substitute for less environmentally-oriented taxes dependent on extent to which carbon-based fuels are displaced.

# Double dividends?

- Carbon prices internalise a major externality.
- Such taxes significantly distort labour markets .
- If such taxes used to cut distortionary income taxes they probably provide more gains than being returned lump-sum – consist with John's argument.
- Help resolve Commonwealth/State agency issues.
- Swapping such carbon taxes for income taxes may not have negative or zero gross costs.
- 'Nothing for nothing'.



# Conclusion

- The future might not look like the present in terms of tax bases.
- Shift from blunt excises to more targeted environmental charges particularly in transport but perhaps also in water use & waste disposal.
- There can be a shift from excises & income taxes at least for a transitional period toward GGE charges.