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Carbon Tax: The simple facts

Snapshot

There's a lot of noise in the media right now as economists, media commentators and political and industry advocates argue over the proposed carbon tax. This debate looks like it may well be the defining issue of the current parliament. There may be broad agreement on achieving a 5 per cent reduction in carbon emissions by 2020 but not on the policies to achieve that, nor on the likely social and economic impacts.

Without endorsing one view or the other, this article attempts to clarify some of the basic facts about a carbon tax and carbon trading, and provide food for thought on its possible impact on future investments.

A tax or a transition?

A good starting point might be to recognise the carbon tax as a major step towards a carbon emissions trading scheme (ETS). There are compensation packages and changes to current tax rebates, as there were with the GST's introduction in 2000, but the key objective is to get ready for carbon trading, not to raise new revenue.

A quick survey shows carbon 'trading' is more common than carbon 'tax'. Thirty three countries and ten US states already have carbon trading, and countries like China, Taiwan and South Korea are developing schemes. By contrast, only six other countries have a carbon tax — Britain, Denmark, Finland, Norway, Sweden and the Netherlands.

So if the plan is for Australia to move into an ETS in 2015, why don't we just start off with one? The answer is we have, sort of. But first it may help to look at the main schemes.

Building blocks

Carbon taxes apply a fixed rate per tonne to carbon emissions, with government policy determining the tax rate. By contrast, an ETS is a system of tradeable permits. Government mandates the total allowable volume of carbon emissions,

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matches this figure with the total allocated via permits, and then allows the carbon or permit price to fluctuate according to market forces. To remain compliant, emitters must own enough units to offset the pollution they produce. They can buy extra units on the open market if they need them or sell excess units if they have them, creating a market in which money can be made and employment created.

Some economists describe the Australian carbon tax as a stage one ETS, with pollution permits readily available at $23 per tonne, but not tradeable. This all changes from 1 July 2015 when the market-based ETS commences.

The stated rationale for starting with a carbon tax, rather than an ETS, is it provides a simpler fixed carbon cost and incentive to reduce emissions, and delivers a mechanism for cushioning the impact of pricing emissions by passing the tax revenue back to households as rebates.

Economic impacts

Debate persists about the economic impact of a carbon tax. Opponents say companies will move offshore, affecting jobs and growth. Conversely, a 2010 survey, for example, found the European countries which introduced carbon taxes between 1994–2004 had not experienced negative impacts on their economic growth.

Locally, where the 50 largest polluters will bear 75 per cent of the tax liability and emissions-intensive, trade-exposed industries (like steel and aluminium production) are largely insulated for five years, the impact of the tax on ASX200 companies is expected to be less than 0.5 per cent.[1]

The Australian Treasury estimates the carbon tax will increase prices by 0.7 per cent in 2012–13. Others argue price increases will be higher. Either way, for those who recall the introduction of the GST in 2000 and its 3 per cent impact on CPI, Treasury predicts the impact of the carbon tax will be about one third of that.

Future investments

Moving away from carbon-based fuels is not simple and will have negative impacts for some companies, communities and households, but it will also open up new industries and strengthen companies invested in less carbon-intensive activities. Coal will remain important but all eyes will be on developments in alternative energy from wind, solar, tidal, and similar sources.

Stability is also vital for investors. The Investor Group on Climate Change, an industry body that includes fund managers such as Colonial, BT, AMP and Perpetual, has welcomed the tax as it provides certainty for the foreseeable future. One of Australia's largest fund managers believes while there may be a negative impact on growth due to uncertainty until the details of the tax are finalised, this will be reversed next year as compensation kicks in.[2]

This is certainly a complex change. It will take time to understand it fully and to identify the companies and investment opportunities for the future.

If you'd like to discuss any aspect of your investment or retirement plans, please give us a call.

[1] *MLC JB Were, Talking Stock, 18 Jul 2011*
[2] *AMP.com.au - Oliver's Insights, June 19 2011*

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