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Using Markets for a Healthy Environment in a Productive Economy

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Introduction

The Australian Treasury describes the wellbeing of people as the total stock of capital – human, physical, social and natural – that is maintained or enhanced for current and future generations. It relates to all aspects of life, and encompasses much more than simple measures of economic activity.

We would argue that truly sustainable society is one that creates wealth without degrading its natural capital.

This means maintaining our environmental assets in a healthy condition, so that they can provide the goods and services that people desire now, and for all the generations who are to follow us.

It means maintaining a stable climate system, it means maintaining our soils and rivers and estuaries and forests and oceans in a healthy condition, and it means protecting for all time those precious gifts of nature – our natural heritage.

In November 2014 the Wentworth Group in consultation with experts in economics, land use planning and law released *Blueprint for a Healthy Environment and a Productive Economy*.

In it we describe the magnitude of the environmental challenges Australia faces, we establish the case that it is possible to grow the economy and protect the environment, and we set out five long-term institutional and economic reforms that we believe are essential to achieve this outcome.

As we all know, even in the best of times, tax reform is difficult, and given the other pressures on deficits and demographic pressures such as the aging of the population, in a world where short term reigns, long term management of natural capital is not a high priority.

In reality, the only way we will get long term economic reform to address long term environmental challenges is if a) such reforms are built into broader public policy reforms; and b) we show this they can be achieved without a significant call on the budget.

A key objective of our paper was therefore to demonstrate a credible economic case that it is possible to grow the economy, create jobs, cut taxes, and do so in a manner that would also lead to the long-term conservation of our nation's natural capital.

We did this because a generation of Australians have not had the conversation that we can grow the economy and have a healthy environment – they only hear that we must sacrifice one to have the other.

Wentworth Group are not economists, so we were delighted that people such as Dr Ken Henry (former Treasury Secretary), Professor Quentin Grafton (Crawford School) and Martijn Wilder who spoke to you yesterday, agreed to contribute to our blueprint.

Having established the case that it is possible to grow the economy, create jobs and have a healthy environment, we set out the 5 major long term institutional and economic reforms that are necessary to achieve this outcome:

1. Avoiding further damage to natural capital, by putting in place regional scale land and water use plans that address the cumulative impacts of new development on the environment;
2. Using markets to finance conservation by removing subsidies that pollute the environment, and instead create economic incentives for business and consumers to conserve our natural capital;
3. Turning around the systemic decline in biodiversity by closing the gaps in our national system of public and private reserves, connecting these across the landscape, and committing to a long-term plan to conserve our endangered native plants, animals and ecosystems;
4. Regionalising the management of Australia's natural resources so that investment decisions are underpinned by an understanding of how landscapes function; and
5. Creating landscape scale, national environmental accounts.

In the context of this broad suite of long-term economic and institutional reforms, let me focus on our proposal to use markets to finance conservation by removing subsidies that pollute the environment, and instead create economic incentives for business and consumers to conserve our natural capital.

We set this case out in detail in a separate paper titled *Using Markets to Conserve Natural Capital*. Both papers are available on the Wentworth Group web site:

<http://wentworthgroup.org/wp-content/uploads/2014/11/Blueprint-for-a-Healthy-Environment-and-a-Productive-Economy-November-2014.pdf>

<http://wentworthgroup.org/wp-content/uploads/2015/06/Wentworth-Group-Blueprint-Technical-Paper-1-Using-Markets-to-Conserve-Natural-Capital-June-2015-FINAL.pdf>

Using Markets to Conserve Natural Capital

Our argument for market reform is centered on the understanding that many market activities damage the environment, but this is often not reflected in the market price of the goods or services these activities produce, and as a consequence the cumulative impacts of individual decisions are often masked within the production of goods and services that people consume.

We argue it is therefore in the public interest for governments to create the economic conditions for these impacts to be incorporated into the cost of doing business, and we identified four opportunities to achieve this:

1. Applying a duty of care, on both private and public land, so that future actions of individuals, businesses and government result in no net long-term harm to the nations' environmental assets;
2. Setting an effective long-term emissions reduction target with a price on carbon to encourage carbon farming to transform the way we farm and manage the Australian landscape;
3. Eliminating fossil fuel subsidies that cause pollution and replacing them with a broad-based land tax to provide a long-term, equitable funding base to pay farmers, indigenous communities and other landholders to restore and maintain environmental assets in a healthy condition; and
4. Developing voluntary, industry-based farm certification, supported by strong and effective regulation, so that suppliers, retailers and consumers can have confidence, and farmers can receive financial benefits for managing their farms sustainably.

Central to this paper is that we are able to show:

- How a price on carbon can drive new investments in landscape conservation; and
- That by eliminating existing fossil fuel subsidies that cause climate change, and using part of those savings to create incentives to restore degraded environmental assets, it is possible to cut taxes and create a healthy and productive Australia, without any impact on the budget or economic growth.

Healthy landscapes store more carbon

One of the benefits of a small population living on a large continent is that we have more opportunities to store carbon in vegetation and soils as part of our response to climate change.

The scale of opportunity is enormous. If Australia were to capture 15% of the biophysical potential of our landscape to store carbon, it would offset the equivalent of 25% of Australia's current greenhouse gas emissions, every year for the next 40 years.

In December 2011, the Australian government introduced a carbon offset scheme, called the Carbon Farming Initiative. It is one of the broadest and most comprehensive schemes of its type anywhere in the world.

Its objectives are to assist in the achievement in Australia's greenhouse gas mitigation obligations in a manner that will protect the environment and improve resilience to the effects of climate change.

Whilst carbon farming has figured prominently in the first round of auctions, CSIRO modeling suggests a price of \$30 tonne is required to leverage landscape scale investments. The first round of the government's Emission Reduction Fund auction set a price of \$14 tonne.

If Australia were to adopt emissions targets consistent with a commitment to limit global warming to 2 degrees, the price on carbon is likely to range between \$30 and \$100 per tonne within 10 years.

Once a price on carbon exceeds \$30 per tonne, the gross investment potential could be in the order of \$4 billion per annum if Australia were to capture 15% of the biophysical potential of our landscape to store carbon.

This scale of investment would not only make a significant contribution to Australia's greenhouse emission reductions, it could transform the way we manage the Australian landscape.

A tax system that conserves natural capital

It is not reasonable to expect landholders to fund the restoration of natural resources that have been degraded by past practices, nor is it practical to do so because of the difficulties producers have in passing these costs through the supply chain to consumers.

We need to make it profitable for Australian farmers and other land managers to provide these services on behalf of the rest of Australia.

The forthcoming Commonwealth review of Australia's taxation system presents such an opportunity, and it could benefit from many of the recommendation of the 2010 Henry Tax Review.

This review identified a broad set of taxation arrangements that would best position Australia to deal with the social, economic and environmental challenges for the next forty years.

The Review did not conclude that the tax system was broken or in crisis, but it did recommend reform to best position Australia's tax system for the future by addressing issues:

- Australia's overall tax levels;
- The distribution of taxes between the Commonwealth, state and territories and local government;
- Improving the efficiency of the tax system;
- Minimising the effects on economic growth; and
- Ensuring that tax settings do not work against environmental goals.

Eliminating fossil fuel subsidies

The starting point for ensuring that tax settings do not work against environmental goals is to phase out subsidies to fossil fuels that create an economic incentive to pollute, in favour of incentives that reward investments in technologies that contribute to protecting the environment.

The WTO defines a subsidy as a financial contribution by a government that confers a benefit. A benefit is conferred when the financial contribution is provided to the recipient on terms that are more favourable than those that could have been obtained from the market.

On the basis of this definition, fossil fuel subsidies and tax expenditures amount to in excess of \$8 billion per annum in Australia. Fuel tax credits alone benefit the fossil fuel sector in excess of \$5 billion: mining (\$2 billion), transport (around \$1 billion), and primary industries (around \$600 million).

A common criticism about the removal of these subsidies is that they are not subsidies because they are inputs into production. There is no case however, in principle, for taxing something more lightly simply because it is a business input. Land is a business input and yet land taxes are the most efficient of all taxes. Labour is the principal input to business, and yet labour is subject to income tax.

A second criticism is that the elimination of these subsidies will cost jobs. Tax subsidies on fossil fuels don't create jobs, they simply mean that there are more jobs in businesses that use a lot of fossil fuels and fewer jobs in businesses that don't use fossil fuels.

Where subsidies are utilised, they should support those industries that will assist in our transition to a low carbon economy, many of which will become industries of the future.

Nowhere is this more obvious than in the support for clean energy, which, by taking advantage of our ability to harness the sun and wind, is now a key part of the global economy and our energy future, bringing with it significant employment growth.

Fossil fuel subsidies belong in the past and are not suited to the needs of a modern economy. It makes no sense to pay for something that will make us worse off, when for less than half the cost we can pay for something that generates benefits for generations.

Conclusion

In conclusion, a truly sustainable society is one that creates wealth without degrading its natural capital. This means maintaining our environmental assets in a healthy condition so that they can provide the goods and services that people desire now, and for all the generations who are to follow us.

We have shown that by integrating the conservation of natural capital into the nation's broader economic and institutional reforms, there is no reason why the Australia of today cannot grow the economy, create jobs and maintain a healthy environment.