

A Measure to Improve the Popularity and Equity of an ETS.

Submission to ETS Paper: John Brookes, Darlington, Western Australia, 25 March 2008

Scope

This submission is concerned with section 5.5 “Compensation for changes in income distribution” in the Emissions Trading Scheme Discussion Paper. It is based on participative and egalitarian principals – and hopes to help make an ETS workable, equitable and popular.

Philosophical Basis

If a limit on greenhouse emissions is enforced in Australia, this should be thought of as an entitlement for each Australian to emit an equal share of that limit. One could argue with this and say that perhaps children should have less of an entitlement than adults, but it would be difficult to put a case that one adult should have more of a right to emit greenhouse gases than another.

Proposal

Some fraction of the revenue raised from the auction of permits will need to be used by government, for reasons identified in the discussion paper. Therefore, it is proposed that the government sell that fraction of permits which will provide it with the revenue needed, and allocate the remainder of the permits equally¹ to all Australians.

Implementation

The extent to which individuals want to participate in the ETS will be up to them. The default position will be for the government to auction their permit allocation on their behalf, and give them the proceeds of the sale, either through the tax system, or through the income support system. People who wish to participate to a greater extent could trade the permits themselves, or appoint an agent to do it for them. The permit allocation could be done annually, providing everyone with a nice bonus, in much the same way as most people with children receive a bonus family payment of \$600 per child each year as a lump sum.

Benefits to Low Income Earners

Perhaps the best feature of such a scheme is that it automatically compensates people on low incomes, and it does so without giving them additional “welfare” payments. With all the negative connotations, resentment and perverse envy associated with “welfare”, this is a good thing. Under this scheme, people who are responsible for the emission of very little greenhouse gases will be better off in real terms, and thus many low income earners² will actually be better off.

¹ With the possibility of different adult/child allocations.

² Low income earners will mainly be low emitters, simply because they don't spend much.

Generating Support for the ETS

This scheme will create a constituency who support the ETS. Some people will be better off under this scheme, and some will be worse off. There is a point at which an individual consumes goods with an embodied permit value equal to the money they make through the sale of their permits, and they are neither better nor worse off. Where this point is depends on (among other things) just what fraction of permits the government needs to keep for its own use. If the government keeps the vast majority of the permits for its own benefit³, then a big majority of people will be worse off. If the government only needs a small fraction of the permits, then it is possible that a sizeable proportion of the population will be better off. If people perceive themselves to be better off, they will support the ETS. Even those who are slightly worse off may feel better off because of the lump sum annual bonus. Thus, if the government can be resolute in resisting lobby groups pleading for a bigger share of the permit revenue cake, and in doing so return most of the cake directly to the people, then the ETS is more likely to achieve popular support.

Generating Support for Tough Emissions Targets

Another benefit of the population having a direct stake in the ETS is that there will be a significant number who will consider themselves losers if government caves in to pressure and sets lax emissions targets. Such action would cause a fall in the value of permits, and people who find their annual bonus is likely to be only \$400 instead of \$800 will not be happy. Thus at least some of the electorate will be pushing for tougher emission targets in pursuit of their own interests (as opposed to a desire to save the world).

Should it be Means Tested?

Some might argue for means testing in the allocation of permits to the public. This is unnecessary. The fact that both wealthy and poor receive the same dollar amount means that the poor receive a bigger percentage increase, which has an effect similar to means testing. Also, any form of means testing would only exacerbate the problem of high effective marginal tax rates for those on low to middle incomes. Means testing is a temptation to government, as it is more politically palatable to save money by means testing than to raise that money by other means. However means testing destroys the idea of a universal entitlement, and the government should strongly resist the temptation.

Problems of the Likely Alternative

If, instead of the scheme proposed here, some of the proceeds of permit sales are given back by way of increased welfare and by cuts in income tax, the benefits outlined above will not eventuate. The possibility will exist for the wealthy to benefit more from tax cuts than the poor do from increases in welfare. There is also the philosophical objection of giving as “welfare” that which is better considered to be an entitlement. Furthermore, if it is given as “welfare”, then the conventional thinking will be to only give enough to cover cost increases caused by an ETS. In effect this would mean that the poor are considered to have less right to emit greenhouse gases than the rich!

³ Or rather, for the common good.

Another problem of a scheme based on changes to the income tax and welfare rates is that there will not be a strong connection between the general public and the ETS. People will, for example, argue that their marginal income tax rates should not increase just because the ETS is not earning as much revenue as was expected. Governments, particularly ones facing an election, would be hard pressed not to allow some disconnect between the ETS and the welfare and tax compensation for the ETS. This would be a bad thing, and will be avoided by implementing the proposals of this submission.

Ease of Implementation

Most of the infrastructure needed to support the scheme outlined here already exists. Virtually all Australians are part of the income support or income tax systems, so delivering to them the proceeds of the sale of their permits will be relatively straightforward. Those who wish to retain and trade their own permits will need to have some sort of permit trading account set up, but many will need this anyway, regardless of which ETS model is adopted.

Open Questions

Within the basic framework provided here, many issues remain. For example, can an individual sell the rights to their future entitlements? When current needs lead to permits being borrowed from future years allocations, will this apply to both government permits and the public's permits, or will future borrowings only be from the governments permits?

Assessment of the Effectiveness of Proposed Schemes

No matter how appealing this or any other scheme is on paper, there is no guarantee that it will work well in practice. Having recently been introduced to the economics experiments of Nobel laureate Vernon Smith, it seems a good idea (at least to me) to conduct a series of such experiments on different ETS models. The on-line gaming environment seems the obvious forum for such experiments. Although the cost of running such experiments will be high (partly because of the costs of setting them up, and partly because of the use of real money to encourage real behaviour from the participants), it will be a lot cheaper than discovering the failures in a model after it has been implemented.

A Stepping Stone to the Future

Lastly, this approach sets the stage for the likely near future, when a nation's emission limit will be based, not on their historic emissions, but solely on their population. If Australians already have the idea of a per-capita right to emit, then it will be easier to convince them of the need to move to a world wide per capita emissions entitlement.