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# Counting the cost of collateral damage

A systemic flaw in economic tools such as taxation and subsidies makes the status quo look less costly than environmental change.

We take it for granted that our future standard of living will be as prosperous as today's, but this confidence is ill-founded. We are in a state of deep vulnerability. Negative externalities, or collateral damage, are creating hazards such as pollution, climate change, dryland salinity and endocrine disruption, which are eroding our hard-earned economic wellbeing, our quality of life, security, environmental amenities and the integrity of eco-systems and the essential services they provide.

As outlined in Environment Business Australia's discussion paper *Australia's Choice*, there are tools that could help us avoid the foreseeable risks ahead. While EBA promotes a broad portfolio of approaches to make up a comprehensive enabling framework, two specific tools in the suite are taxation and subsidies, both of which are supposed to deliver outcomes that society desires.

However, a systemic flaw has developed over many generations. Instead of a system capable of assisting long-range planning for the changes needed by an economy, subsidies have artificially deflated the cost (and hence the end price) of recipient goods and services while simultaneously denying the marketplace the timely and meaningful intelligence it needs to be an effective intermediary. The result is seen in asset degradation, because the price of averting problems has seemed high in the short-term compared with continuing status quo activities.

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One has to ask: how rational is an economist who focuses solely on short-term costs rather than a cost-benefit analysis of the long-term benefits of transition to less intensive and damaging production and consumption processes? A rational approach would surely engage both sides of the balance sheet and take into account the exponential growth of costs associated with negative externalities.

Debunking the high cost theory are the findings from the EU ExternE study. Analysts found that the cost of producing electricity from coal or oil would double if external costs such as damage to the environment and health were taken into account. It is estimated this would represent 1-2 per cent of the EU's GDP, and this does not even include the cost of global warming. These costs have to be covered by society at large since they are not included in the bills electricity consumers pay.

### Using taxpayer dollars effectively

According to PhD research at the University of NSW, subsidies that favour fossil fuels now amount to some $9 billion per annum in Australia through schemes such as tax benefits for exploration and company cars, or subsidised energy for the really big users such as aluminium – hardly the sort of thing that encourages quantum leaps in energy efficiency or zero emissions technology. Compare that with the Federal Government's $500 million Low Emission Technology Demonstration Fund (LETDF).

Re-allocation of perverse funding, be it direct or indirect, could buy a lot of innovation, plant retrofitting and the building of Australia's next competitive edge. But if equal weight is not given to securing full cost price recovery for energy, increasing energy efficiency uptake rates and taking better advantage of renewable energy options, then Australia may find itself locked out of competitive reform.

In the competition for market share the advantage often lies with the incumbent, so new technology solutions to major waste and pollution problems are sometimes referred to as a "taxpayer grab" (by those who benefit from the status quo, of course).

But there are immense savings to be made to the public purse by creating national and international programs capable of reducing negative externalities associated with current production. Take the automotive industry; a proactive, job-creating, emissions reducing, economic driver program would involve the three levels of government mandating that all their fleet vehicles have to meet benchmark fuel efficiency and low emissions standards. This would give a significant impetus to automotive companies to retool production plants.

The size of the government fleet market would effectively reduce the unit cost of vehicles for consumers, while creating a supply of highly efficient vehicles for the second-hand market. Combine this with lower air pollution and opportunities for export of clean vehicles into China and India, in particular, and it becomes a rather effective use of the taxpayer dollar in my view!

Taxation and subsidy reform is not necessarily a debate about picking winners, but it certainly could be a way to avoid picking the losers in tomorrow's marketplace. EBA's recommendation is for a system capable of weaving out old technologies and weaving in new ones. Rather than propping up uncompetitive processes we should focus on those which require fewer raw materials and less energy, emit no pollution and create no waste. That is a competitive proposition for Australia – as it is for China or India.

*Find Australia's Choice at www.environmentbusiness.com.au*