Giving with both hands

Adding up the federal handouts that encourage pollution

AUSTRALIAN CONSERVATION FOUNDATION

Summary

Australian policies to support a transition to a clean economy are in a state of confusion.

On one hand, the Federal Government provides significant financial incentives that encourage fossil fuel use and greenhouse pollution. On the other hand, the government's Emissions Reduction Fund uses tax dollars to pay polluters to reduce their greenhouse emissions.

ACF estimates that federal budget handouts that encourage pollution will amount to $47 billion in the four years between 2014-15 and 2017-18. Meanwhile the Federal Government's Emissions Reduction Fund – effectively another handout – totals just $1.1 billion over the same period.

The approach is illogical. Companies are being subsidised to pollute while also being offered subsidies to cut pollution.

The Government is giving to big polluters with both hands.

This year's mid-year economic and fiscal statement (MYEFO) includes subsidies or tax breaks so:

- Certain businesses receive a refund on their fuel tax, through the Fuel Tax Credits scheme.
- Airline fuel is taxed at a lower rate than other fuels.
- Oil, gas and petroleum companies can depreciate capital assets at a faster rate than many other sectors, reducing their tax burden.

Together these handouts will cost the budget $35 billion over the next four financial years.

In addition to these handouts, the repeal of Australia's carbon price provides an implicit subsidy to big polluters, which no longer have to pay for the pollution they emit and the damage it causes. The cost of their pollution through the increasing impacts of climate change will be borne by other sectors of the economy (e.g. tourism, health, emergency services, insurance) and future generations.

The Climate Institute estimates the Government has foregone $12.6 billion in revenue over four years as a result of repealing Australia's price on pollution. The repeal distorts investment, production and consumption decisions and provides a financial windfall for big polluters.

The Government has replaced the carbon price with an Emissions Reduction Fund as its main climate change policy.

In budgetary terms the major difference between the two approaches is that while the carbon price provided revenue to the budget, the Emissions Reduction Fund puts the burden on taxpayers to pay businesses to reduce their pollution.

The Federal Government can rectify this confused approach to energy use by phasing out subsidies and tax breaks for fossil fuel exploration, production and consumption, and returning to a polluter-pays model to cut emissions.

Table 1. **Subsidies, tax breaks and other handouts in the Federal Budget that encourage fossil fuel use and greenhouse gas pollution**

	Category	Units	2014-15	2015-16	2016-17	2017-18	Total
Fuel Tax Credits scheme	Tax expenditure	m	$6,270	$6,822	$7,211	$7,615	**$27,918**
Concessional rate of excise levied on aviation gasoline and aviation turbine fuel	Tax expenditure	m	$1,280	$1,340	$1,400	$1,470	**$5,490**
Statutory effective life caps	Tax expenditure	m	$240	$490	$349	$328	**$1,407**
Repeal of carbon pricing mechanism	Revenue foregone	m	$7,200	$1,800	$1,750	$1,800	**$12,550**
Total		m	**$14,990**	**$10,452**	**$10,710**	**$11,213**	**$47,365**

Recommendations

Fuel Tax Credits scheme

RECOMMENDATION Phase out fuel tax credits over the forward estimates so that all businesses pay equivalent fuel tax. As an interim measure to smooth the transition, businesses should be entitled to claim up to a certain capped amount each year.

Concessional rate of excise levied on aviation gasoline and aviation turbine fuel

RECOMMENDATION Phase out the concessional rate of excise levied on aviation gasoline and aviation turbine fuel over the forward estimates.

Accelerated depreciation for the oil and gas industry

RECOMMENDATION Phase out statutory effective life caps over the forward estimates.

Repeal of the carbon pricing mechanism

RECOMMENDATION Introduce an economy-wide price on greenhouse gas pollution to drive decarbonisation in line with scientific advice.

Emissions Reduction Fund

RECOMMENDATION Replace the Emissions Reduction Fund with an economy-wide price on greenhouse gas pollution in line with scientific advice.

What is a subsidy?

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The Organisation for Economic Cooperation and Development (OECD) defines a subsidy as:

…various types of policy-related transfers provided by governments and their agents, along with foregone revenues, [and] the more common notion of a subsidy as a direct government payment.

Australia, as a member of the World Trade Organisation, has accepted this definition of subsidies.[1]

Based on the OECD definition above, the Fuel Tax Credits scheme is an example of **foregone revenues**. Statutory effective life caps are an example of **foregone revenues**. The concessional rate of excise levied on aviation gasoline and aviation turbine fuel is another example of **foregone revenues**. Removing the price on greenhouse gas pollution is an example of a **policy-related transfer** subsidy. The Emissions Reduction Fund is an example of a **direct government payment**.

The International Monetary Fund (IMF) has highlighted that subsidies can encourage excessive energy consumption, reduce incentives for investment in renewable energy and accelerate the depletion of natural resources. Subsidies that support the production and consumption of fossil fuels need to be phased out if Australia is to transition to a low-carbon economy.

Handouts to polluters that encourage fossil fuel use and greenhouse pollution

Fuel Tax Credits scheme

The Fuel Tax Credits scheme exempts certain business from paying the fuel excise tax levied on liquid, gaseous and blended fuels. Fuel tax credits are set out in law in the Fuel Tax Act 2006. Fuel tax credits represent an effective subsidy to eligible businesses. Eligible businesses pay the fuel tax and then claim a credit back via their business activity statements. The mining industry is the largest beneficiary of the Fuel Tax Credit scheme, claiming 39 per cent or $2.1bn of the total value of credits claimed in 2012-13.[2]

Fuel excise amounts are set in law in the Schedule to the Excise Tariff Act 1921. Following the re-introduction of indexation of fuel excise via the Excise Tariff Proposal (No. 1) 2014 and Customs Tariff Proposal (No. 1) 2014, fuel excise is now set at 38.60 cents for liquid fuels, 10.1 cents for liquefied petroleum gas (LPG), 21.2 cents for compressed natural gas (CNG) and liquefied natural gas (LNG).[3]

The Australian Taxation Office (ATO) list the fuel tax credit amounts on their website and in the *Fuel tax credits for business* guide.[2] The amounts listed by the ATO as of December 2014 are less than the new fuel excise rates. Following the passing of the Tax and Superannuation Laws Amendment (2014 Measures No. 6) Bill 2014, however, fuel tax credits will now also be increased in-line with bi-annual indexation of fuel excise amounts.[4]

Aside from a small proportion associated with the reintroduction of excise indexation, fuel tax is not hypothecated for spending on roads. The tax goes into the Commonwealth's Consolidated Revenue Fund to be spent according to the Government's budget.[5,6]

According to the 2014-15 Australian Federal Budget, the cost of the Fuel Tax Credits scheme to ordinary taxpayers is expected to increase in line with the annual increase in fuel excise and because of expected increases in claims by eligible businesses (particularly from the mining industry) commensurate with higher diesel consumption.

Table 1: Fuel tax credits scheme expense [7]

	Category	Units	2014-15	2015-16	2016-17	2017-18	Total
Fuel Tax Credits scheme	Tax expenditure	m	$6,270	$6,822	$7,211	$7,615	**$27,918**

Legislative reference: Fuel Tax Act 2006, Chapter 3 – Fuel tax credits

RECOMMENDATION Phase out fuel tax credits over the forward estimates so that all businesses pay equivalent fuel tax. As an interim measure to smooth the transition, businesses should be entitled to claim up to a certain capped amount each year.

Footnotes

1 According to OECD (2010) Analysis of the scope of energy subsidies and suggestions for the G20 initiative, p.8, paragraph 9.

2 ATO (2014) Taxation statistics 2011-12, Table 3: Excise – Fuel tax credits scheme – claims paid, by fine industry, 2006-07 to 2012-13 financial years.

3 ATO (2014) Reintroduction of fuel excise indexation, available online: https://www.ato.gov.au/General/New-legislation/In-detail/Indirect-taxes/Excise/Reintroduction-of-fuel-excise-indexation/

4 Parliament of Australia (2014) Tax and Superannuation Laws Amendment (2014 Measures No. 6) Bill 2014 – Explanatory Memorandum.

5 Webb, Richard (2001) Some Issues in Fuel Taxation, Current issues brief 2 2001-02

6 Parliament of Australia (2014) Excise Tariff Amendment (Fuel Indexation) Bill 2014, Explanatory Memorandum

7 Source: Australian Government (2014) Budget 2014-15, Statement 6: Expenses and Net Capital Investment, available online: http://www.budget.gov.au/2014-15/content/bp1/html/bp1_bst6-01.htm

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Concessional rate of excise levied on aviation gasoline and aviation turbine fuel

Gasoline and kerosene used for aircraft are subject to a lower rate of excise than fuels used in other vehicles. Specifically, gasoline for use as fuel in aircraft is only taxed at 3.556 cents per litre while gasoline for other uses is taxed at 38.6 cents, up from 38.143 cents following the reintroduction of bi-annual indexation of fuel excise.[8]

According to the OECD, consumers of aviation gasoline and turbine fuel have paid a reduced rate of excise tax since March 1956.[9] This encourages the use of aviation gasoline and fuel vis-à-vis other forms of transport.

Table 2: Concessional rate of excise levied on aviation gasoline and aviation turbine fuel estimates

	Category	Units	2014-15	2015-16	2016-17	2017-18	Total
Concessional rate of excise levied on aviation gasoline and aviation turbine fuel	Tax expenditure	m	$1,280	$1,340	$1,400	$1,470	**$5,490**

Legislative reference: Item 10 of the Schedule to the Excise Tariff Act 1921

RECOMMENDATION Phase out the concessional rate of excise levied on aviation gasoline and aviation turbine fuel over the forward estimates.

Footnotes

8 Figures for excise rates come from Item 10 of the Schedule to the Excise Tariff Act 1921, reintroduction of fuel excise indexation explained at ATO (2014) Reintroduction of fuel excise indexation, available online: https://www.ato.gov.au/General/New-legislation/In-detail/Indirect-taxes/Excise/Reintroduction-of-fuel-excise-indexation/

9 OECD (2011) Inventory of estimated budgetary support and tax expenditures for fossil fuels, Chapter 2: Australia.

10 Source: Australian Government (2014) Budget 2014-15, Statement 5 - Appendix B: Tax Expenditure, Table B1: Estimates of large measured tax expenditure, available online: http://www.budget.gov.au/2014-15/content/bp1/html/bp1_bst5-05.htm

Accelerated depreciation for the oil and gas industry

Statutory effective life caps determine the number of years over which a company can depreciate a capital asset. The legislated caps are detailed in section 40-102 of the *Income Tax Assessment Act 1997*. Typically they result in a shorter time period for depreciation than would otherwise be the case, based on the capital asset's useful economic life.

Legislated caps were supposed to be removed when the company tax rate was reduced from 36 per cent to 30 per cent following the Ralph Review of Business Taxation.[11] But after industry lobbying, the Government decided to retain legislated caps.

By condensing the depreciation period into a shorter time than the useful operating life of the asset, certain sectors can effectively postpone paying tax. This is akin to an interest free loan from the Government to these companies. This handout distorts production and investment decisions. It provides an unfair advantage to the oil and gas sector – a sector that is the source of much climate-changing greenhouse pollution – over other industries that do not have such favourable tax arrangements. It is an unnecessary subsidy that should be phased out.

Statutory effective life caps covering assets used in the oil and gas industry are listed in the table below.

Table 3: **Legislated capped life of certain assets used in specified industries**[12]

Kind of depreciating asset	Industry in which the asset is used	Period
Gas transmission asset	Gas supply	20 years
Gas distribution asset	Gas supply	20 years
Oil production asset (other than an electricity generation asset or an offshore platform)	Oil and gas extraction	15 years
Gas production asset (other than an electricity generation asset or an offshore platform)	Oil and gas extraction	15 years
Offshore platform	Oil and gas extraction	20 years
Asset (other than an electricity generation asset)used to manufacture condensate, crude oil, domestic gas, liquid natural gas or liquid petroleum gas but not if the manufacture occurs in an oil refinery	Petroleum refining	15 years

Source: Section 40-102 of the Income Tax Assessment Act 1997

Table 4: **Estimates of statutory effective life caps tax expenditure ($m)**[13]

	Category	2014-15	2015-16	2016-17	2017-18	Total
Statutory effective life caps – all sectors	Tax expenditure	1,280	1,380	1,400	1,470	**5,530**
Statutory effective life caps – *oil, gas and petroleum sectors*	Tax expenditure	240	490	380	399	**1,509**

Legislative reference: Section 40-102 of the Income Tax Assessment Act 1997

RECOMMENDATION Phase out statutory effective life caps over the forward estimates.

Footnotes

11 Australian Conservation Foundation (2011) Drill now, Pay Later: The growing cost of tax breaks for the oil and gas industry in Australia.

12 Income Tax Assessment Act 1997, Section 40.102, Capped life of certain depreciating assets

13 Source: Australian Government (2014) Budget 2014-15, Statement 5 - Appendix B: Tax Expenditure, Table B1: Estimates of large measured tax expenditure, available online: http://www.budget.gov.au/2014-15/content/bp1/html/bp1_bst5-05.htm
2016-17 and 2017-18 are ACF estimates based on 2014-15 and 2015-16 estimates by Environment Victoria and Market Forces in their pre-budget briefing paper: An analysis of Australian Government tax measures that encourage fossil fuel use.

Repeal of the carbon pricing mechanism

In 2014, the Government repealed the *Clean Energy Act 2011* along with Australia's carbon pricing mechanism.[14]

Analysis by The Climate Institute estimates that the repeal of the carbon pricing mechanism has cost the Federal Budget $18.15 billion between 2014 and 2020. Over the next four years, the cost to the budget is estimated to be $12.6 billion.[15]

As a result, Australia's most greenhouse gas intensive companies no longer pay a price for the pollution they produce. This is an implicit subsidy to these industries and distorts investment, production and consumption decisions. While households, farmers and small businesses pay the costs of climate change, greenhouse gas intensive companies pollute the atmosphere for free.

Table 5: **Repeal of the carbon pricing mechanism**[15]

	Category	Units	2014-15	2015-16	2016-17	2017-18	Total
Repeal of Carbon Pricing Mechanism	Revenue foregone	m	$7,200	$1,800	$1,750	$1,800	**$12,550**

RECOMMENDATION Introduce an economy-wide price on greenhouse gas pollution to drive decarbonisation in line with scientific advice.

Footnotes

14 Clean Energy Regulator (2014) Carbon pricing mechanism repeal, available online: http://www.cleanenergyregulator.gov.au/Carbon-Pricing-Mechanism/Carbon-pricing-mechanism-repeal/Pages/default.aspx

15 Source: The Climate Institute (2014) Policy Brief: Fiscal impact of ERF and carbon laws repeal, April 2014, available online: http://climateinstitute.org.au/verve/_resources/PolicyBrief_ERFCarbon_Revenue_loss_BudgetImpact.pdf

Handouts to polluters to reduce greenhouse gas pollution

Emissions Reduction Fund

The Emissions Reduction Fund is the Federal Government's key policy to cut climate-changing pollution through the so-called 'direct action' approach. Using a voluntary reverse auction, tender process, or 'any other process' undertaken by the Clean Energy Regulator, the Government will give funds to selected entities to subsidise their efforts to reduce pollution. In essence, the Government provides a cash payment directly to companies to reduce pollution and make their operations more efficient.

The Emissions Reduction Fund passed the Parliament as an amendment to the *Carbon Farming Initiative Amendment Act 2014*. This Act largely covers the fund's architecture, while the initial funding envelope of $1.1 billion over the next four years passed both houses within the 2014-15 Appropriation Bills. The Government plans to spend $2.55 billion over ten years (subject to Cabinet approval).

Table 6: Emissions Reduction Fund expenditure over the forward estimates[16]

2014-15	2015-16	2016-17	2017-18
$75.5m	$299.8m	$354.5m	$416.9m

Table 7: Indicative Emissions Reduction Fund expenditure over a ten year life span[17]

2014–15	2015–16	2016–17	2017–18	2018–19	2019–20	2020–21	2021–22	2022–23	2023–24
$75.5m	$299.8m	$354.5m	$416.9m	$463.4m	$434.4m	$210.1m	$155.4m	$93m	$47m

DIRECT ACTION UNDERMINES THE 'POLLUTER PAYS' PRINCIPLE

The concept of 'polluter pays' is central to most mainstream economic approaches to tackling climate change. In order to overcome the failure of polluters to properly account for the damage caused by their pollution, policy-makers calculate the cost to society and impose that on those responsible for the damage.

Australia's carbon price was based on this principle. It imposed an obligation on polluters to purchase permits for each tonne of pollution they created in recognition of the cost that pollution had on the economy by contributing to climate change. This meant the emission of greenhouse gases had a direct economic cost on the companies responsible, rather than imposing the cost on the wider society through environmental damage. This approach created an incentive for businesses to find new methods of production that used less energy and produced less pollution.

Direct Action reverses this long-held principle. Instead, it offers a cash incentive to undertake projects that will reduce pollution. Rather than imposing a cost on those responsible for pollution, taxpayers bear the cost.

Footnotes

16 Source: Australian Government (2014), Budget 2014-15, Budget Paper No.2, Part 2: Expense Measures, pp 102-103, available online: http://www.budget.gov.au/2014-15/content/bp2/html/index.htm

17 Source: Alex St John and Kai Swoboda (2014), *Australian Parliamentary Library Budget Review 2014-15*, "The Emissions Reduction Fund," available at http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/BudgetReview201415/Emissions

In many cases, this will likely mean a subsidy to purchase new capital equipment to make operations more energy efficient. However, it is likely many of these projects would have been implemented even without Government support, making it difficult to identify whether projects are actually delivering additional pollution abatement.[18]

In other words, the taxpayer will provide a subsidy for a project that may already make economic sense.

By creating a subsidy for projects that reduce emissions, with no other obligation or incentive to reduce pollution, the Government is creating an incentive"to hold back investments that reduce energy use or emissions unless they are subsidised."[19]

> *"A policy… where industry was able to freely pollute… and the Government was just spending more and more taxpayers' money to offset it, that would become a very expensive charge on the budget."*[20]
> – The Hon Malcom Turnbull MP, Minister for Communications

RECOMMENDATION Replace the Emissions Reduction Fund with an economy-wide price on greenhouse gas pollution in line with scientific advice.

Footnotes

18 Burke, P., (2014), Submission to the Senate Standing Committees on Environment and Communication, Parliament of Australia, Inquiry into the Australian Government's Direct Action Plan

19 Jotzo, F., (2014), Submission to the Senate Standing Committees on Environment and Communication, Parliament of Australia, Inquiry into the Australian Government's Direct Action Plan

20 Turnbull, M. (2011), Interview on *Lateline*, 18 May 2011, Transcript at http://www.abc.net.au/lateline/content/2011/s3220679.htm

Conclusion

ACF estimates that federal budget handouts that encourage pollution will amount to $47 billion in the four years between 2014-15 and 2017-18. Meanwhile the Federal Government's Emissions Reduction Fund – effectively another handout – totals just $1.1 billion over the same period.

The Federal Government's approach to climate change and energy use lacks logic. On one hand, it is paying polluters to produce and use fossil fuels. On the other hand, it is paying polluters to cut pollution.

Australia needs credible policies to reduce greenhouse gas pollution to support a transition to a clean economy. Supporting this transition means phasing out budgetary support for fossil fuel production and use.

Phasing out these subsidies would:

- Provide incentives for companies to reduce their use of fossil fuels but increase energy productivity
- Provide signals to investors to allocate capital away from the most greenhouse gas intensive companies, towards low-carbon leaders
- Improve the budget bottom line by reducing direct budget expenditure and revenue foregone via tax expenditures.

The Federal Government can rectify this incoherent situation by phasing out subsidies for fossil fuel exploration, production and consumption and returning to a polluter pays approach to greenhouse gas emissions.

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Change today for
a sustainable future

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