Why a carbon tax is a direct attack on living standards

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Not a day passes without the media demonstrating just how bad our economic commentariat are. George Megalogenis, a senior journalist and an economist with *The Australian*, delivered the outrageous howler that a carbon tax "is no different to the GST". (*The GST shows the way*, 5 July 2008). He then complained that compensating consumers for the rise in electricity prices that a carbon tax would produce is tantamount to a bribe.

In a more recent article he falsely stated that Co2 is a pollutant. (*Sugar-coating the carbon*, 20 December 2008). It is not: it is a nutrient. From this he argued that a carbon tax was necessary to force "the nation to switch to cleaner energy sources and production". This was followed by an attack on the policy of compensating consumers for the resulting rise in electricity prices because such a policy it would "send the wrong message politically". At least he is being honest by admitting that it is impossible to fully compensate consumers for the severe rise in electricity prices that a carbon tax would bring about.

It is ludicrous to say that a carbon tax is no different from a consumption tax, which the GST is supposed to be, particularly when the same person praises consumption taxes[1] for encouraging investment. While it is obvious that the GST is aimed at consumer goods it ought to be equally obvious that the carbon tax is aimed exclusively at producer goods. However, some argue that as the GST on electricity had no ill-effects on electricity generation neither will a carbon tax. Those who support this view have absolutely no knowledge of capital theory.

The important thing to note is that the carbon tax is designed to strike at certain types of investments, i.e., coal-fuelled power plants. Proponents of this policy, of which Megalogenis is one, readily admit this but argue that the tax is still necessary because it would force businesses to invest in "cleaner energy sources and production". But why don't businesses willing invest in these projects? Because, as Megalogenis well understands, they cannot pay for themselves. In order to make them profitable the government must destroy more efficient alternatives. And this means lowering living standards.

(I should add that if the government begins — as it has in Victoria — by forbidding the expansion of electricity capacity, except for so-called "cleaner alternatives, this would make blackouts inevitable)[2].

However, in order to grasp just how damaging a carbon tax would be we need to employ Austrian capital theory. Austrians understand that capital consists of heterogeneous concrete goods of varying degrees of specificity and which are

complementary in character. These goods form a structure consisting of complex stages of production. Without savings this structure could not exist.

In a free market entrepreneurs will organise capital goods in a way that will maximize their net incomes. This means combining capital and labour to provide the most economically efficient arrangements. A coal-fuelled power station is one such arrangement. Our carbon tax grenadiers believe that these power stations can be safely taxed out of existence because "cleaner energy sources" would provide a reasonable alternative, even though it might be somewhat more expensive. (I'm afraid things might get a little more difficult from this point on).

Megalogenis argues that implementing a carbon tax "begins with a circular transaction of revenue coming in and tax cuts going out". But this view of how goods and incomes move is a dangerous fallacy. There is no circular flow of income. This fallacy ignores the role of time by assuming that everything happens simultaneously. Moreover, production consists of a single stage in which there are no savings or intermediate goods and capital goods are homogeneous. (They are perfect substitutes for each other). So long as consumption is maintained so is the flow of goods. It is basically a timeless model the influence of which leads the conclusion that a carbon tax would be basically harmless.

Austrians, on the other hand, stress that goods flow down the production structure and money flows up; that production happens through time and that intermediate goods pass from one stage of production to another before reaching their eventual destinations. This fits with the view of capital as complementary heterogeneous goods.

Once this is understood the dangers of the carbon tax can be properly outlined. Coal-fuelled power stations have — because of indivisibilities — great economies of scale, meaning that costs fall as output rises. It will take little thought on the reader's part to conclude that any sensible alternative would also have to enjoy economies of scale if a destructive rise in production costs and hence the price of electricity is to be avoided. In plain English, there must be no significant gap in production costs between the two capital combinations.

Unfortunately Mr Megalogenis's alternative energy sources suffer from massive diseconomies of scale, the very opposite of economies of scale[3]. These alternatives cannot increase output without increasing costs. This is because they suffer from insurmountable natural limitations, by which I mean the laws of physics as well as economics. (Only now is the public getting some idea of just how costly this exercise in green economic illiteracy will be[4]).

Once the carbon tax begins to take effect coal-fuelled power stations will start closing down. The loss in output would have to be taken up by the alternative sources, which means production costs would continue to climb. What we have here is the outright destruction of capital (the coal-fuelled power station) on one hand the dissipation of capital (the alternatives) on the other hand.

It's easy to understand the destruction of capital part. The coal-fuelled plant has been closed and nearly all of its capital components, because of their specificity, will have to be scrapped. The dissipation of capital is not so easy to discern. A malinvestment is the result of the entrepreneur's failure to accurately forecast market conditions. As a consequence of this failure he suffers losses. But when the government uses its power to impose an economically inferior alternative — one that would suffer losses in a free market — it is literally dissipating capital.

Therefore, in using a carbon tax to direct capital into lines of production that will distort the production structure the government must eventually lower living standards. To argue — as some do — that this is a market-oriented policy that produces a competitive result is truly bizarre.

By complementarity it is not merely meant that capital goods must be combined in such a way that their productive services fit together but that the same holds for other stages of production. When an entrepreneur begins a project he does so not only in the expectation that the complementary capital goods will be available but that the same holds for the other stages of production. If this is not the case then his own project could be severely hampered if not aborted

Coal-fuelled power stations obviously provide electricity for the production structure. The question is: How would these companies be affected by a massive increase in electricity prices? Obviously these companies would have taken into account electricity prices when they first invested in plant and equipment. But bygones are bygones.

We can therefore conclude that the energy intensive firms would be the hardest hit. Being energy intensive we can deduce that they are also capital intensive, which would tend to place them further up the production structure. Moreover, these firms will employ highly specific capital goods. The greater the specificity of these goods the greater will be the cost of adjustment. In some cases the costs will be too high and these firms will either shut down fairly quickly or soldier on until their returns no longer cover their costs of production.

The possibility that the increase in electricity prices may reduce demand to the point where the company has to close its doors should also be considered. One can easily imagine a large number of firms moving their operations overseas to escape the tax and hence bankruptcy. (Europe's ***"carbon trading system has pushed electricity prices even higher while energy-intensive companies are forced to close down"***). As we move closer to the point of consumption where companies tend to be more labour intensive the loss of capital will not be so great. The loss of jobs is another matter.

Although the following observation was made with respect to another topic, I think it is appropriate to the present debate.

It may sometimes be expedient for a man to heat the stove with his furniture. But if he does, he should know what the remoter effects will be. He should not delude himself by believing that he has discovered a wonderful new method of heating his premises. (Ludwig von Mises, *Human Action, Henry Regenery Company*, 1963, p. 654).

Note: The idea of man-made global warming is losing its appeal. More and more scientists are coming out against it. For example, Dr. John S. Theon, formerly of the Institute for Global Environmental Strategies, Arlington, publicly announced that he is a sceptic. He also stated that Hansen (a noted global warming fanatic) had "embarrassed NASA" with his alarmist claims and that he was never "was never muzzled". Theon is now one of many and their numbers are growing.

1. It is impossible to have a pure consumption tax. All consumption taxes resolve themselves into income taxes and must therefore have an effect on savings and investment.

2. In the last couple of days Melbourne has suffered blackouts because demand exceeded capacity. For this we can thank the Labor Government and the half-witted Liberal Party.

3. ***How the Bracks' Government will cut Victorians' living standards*** and **Lefty journo pushes green solar scam**

4. "Even the lower target of a 10 per cent cut would push the price of carbon emissions to levels that would close down 15 per cent of the nation's electricity generating capacity on the east coast and require $33billion in new investment in replacement clean energy generation, such as wind, solar, combined cycle gas turbine and geothermal power". (Lenore Taylor, *Power plants in danger from emissions trading scheme*, *The Australian*, 25 July 2008). In my opinion the costs have still been greatly underestimated.

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