

**IN CONFIDENCE**  
**TREASURY EXECUTIVE MINUTE**

Minute No.

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11 October 2010

Deputy Prime Minister and Treasurer

[s 22]      **A CARBON PRICE** [s 22]

**Timing:** At your convenience.

**Recommendation:** That you note this briefing on developing a household assistance package.

**Noted**

Signature: .....

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**KEY POINTS**

[s 22]

- Framing questions for a household assistance package would include consideration of:
  - What is the cost of living impact?
  - Why provide household assistance?
  - Who should assistance be provided to and when?
  - How should assistance be delivered?

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**POSSIBLE TALKING POINTS**

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BACKGROUND FACTS

- Modelling has shown that taking action to reduce carbon emissions will lower annual economic growth by one-tenth of one per cent (0.1%).
- Taking early action to reduce carbon pollution costs less than delaying action and smoothes the transition to a low pollution economy.
- Introducing a price on carbon is a long-term pro-growth strategy.
- By introducing a price on carbon, the Government will transform the economy and build the low emissions jobs of the future.
- A price on carbon will have a modest impact on the cost of living for Australian households.
- Australia is not the only country taking action to reduce carbon pollution. Many developed and developing countries have already introduced measures.

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**What is the cost of living impact?**

A carbon price would increase the cost of living for households because the production of almost all household consumables requires some carbon emissions. The initial introduction of a carbon price is expected to have the greatest impact on households’ cost of living, with future market based carbon price changes expected to have a much smaller impact.

The strongest price changes would be in the most carbon intensive goods, such as electricity and gas. The change in the relative price of goods would then drive household behaviour change, with households substituting to less carbon intensive goods over time.

Low-income households will experience a proportionately larger impact because they generally spend more of their income on emissions intensive goods and may be less able to quickly substitute to other goods or adopt low emissions technologies.

In addressing concerns about the cost of living impact of a carbon price, due recognition should be given to emission intensive goods that are already rapidly rising in price. For example, according to the ABS, electricity prices have risen by 40 per cent over the last three years and recent retail price decisions by some state and territory regulators have allowed large price rises (up to 13 per cent for 2010-11 in Queensland). (For more information see [EM 2010/2436](#) dated 1 October 2010.)

A carbon price will also affect wealth as the change in prices flows through to the value of financial assets, including shares, and reduces the real value of savings.

*What happened in the CPRS?*

The CPRS, as proposed in November 2009 after negotiation with the Opposition, was estimated to increase household costs by 1.1 per cent over the first two years.

Item	Weekly (nominal dollars)	Annual (nominal dollars)
Electricity 2011-12 (7%)	\$1.70	\$88
2012-13 (12%)	\$2.30	\$120
Gas 2011-12 (4%)	\$0.60	\$31
2012-13 (7%)	\$1.00	\$52
Food – over two years (<1%)	\$1.30	\$68
Overall price impact over two years	\$12.00	\$624

Treasury modelling for the CPRS estimated the direct impact of the carbon price on items such as electricity and gas, and the indirect impact on other goods and services consumed by households.

The estimated price impacts for different household types under the CPRS were based on household expenditure data collected by the Australian Bureau of Statistics.

The modelling took into account different consumption patterns by different household types (for example, it reflects the fact that pensioners spend a higher proportion of their incomes on energy than other households).

The CPRS cost of living impacts were assessed on a ‘morning after’ basis assuming no behaviour change in order to ensure that the most vulnerable households were not worse off during the transition to the scheme.

Under the CPRS the Government did not propose any compensation for households for any anticipated change in wealth.

### **Why provide household assistance?**

The Government has made a commitment that all revenue raised from the imposition of a carbon price would be returned to Australian households and businesses.

The best assistance that can be provided is direct cash assistance to households because:

- any increase in the cost of production that flows from the introduction of a carbon price will ultimately be borne by households through higher prices;
- assistance to other specific sectors of the domestic economy are likely to be distortionary, and will blunt the relative price impacts and the resulting behaviour change; and
- clear and simple household assistance is critical to countering community concern about cost of living impacts and thus gaining community support for the introduction of a carbon price.

Alternatively, a household assistance package could (in part at least) assist households with transition costs (for example, helping households to become more energy efficient).

### *What happened in the CPRS?*

The AFTS Review panel provided guiding principles to the Government for the design of CPRS household assistance. (A copy of the principles are at [Attachment C.](#)) These principles continue to be relevant to the design of any future package.

For the CPRS, as at November 2009, around half of all assistance provided was direct cash assistance to households.

In addition, households benefited from indirect assistance, for example, through ‘cent for cent’ fuel tax reductions and energy efficiency measures.

However, the Government decided *not* to compensate households for the cost of living impact from the Renewable Energy Target.

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low-income households because they suffer a proportionately larger price impact and may be less able to quickly substitute to other goods.

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**AUSTRALIA'S FUTURE TAX SYSTEM REVIEW PANEL: GUIDING PRINCIPLES****Targeting**

First, assistance should aim to provide an amount up to the degree of expected household real income lost from the Scheme and rely solely on relative price changes to provide the incentive to reduce carbon pollution.

The extent of indirect assistance reduces the need for direct assistance (such as increased benefits or lower income taxes).

Households tend to be better off where direct assistance is untied and does not require them to purchase specific goods or services.

A feasible assistance package assists people with the higher prices of goods and services they *currently* consume, even though the higher prices will encourage them to switch to cheaper or less carbon emitting products. Therefore, some overcompensation should be expected.

Since the Scheme's primary purpose is to change behaviour, it should not be used to change the distribution of the tax burden across different household incomes. Avoiding real reductions in household incomes reduces the risk that wage earners will seek assistance through wage demands.

**Addressing distortions**

Second, assistance should aim to reduce existing distortions, rather than add to them.

Household assistance might consider opportunities to reduce existing work disincentives created by the tax and transfer system. While assistance to those outside the tax system must be through increased transfer payments, it is preferable that assistance to those who pay income tax be delivered through lower personal taxes rather than increased transfer payments.

Also, the Scheme should not replicate existing anomalies in the current fuel excise system, to the extent it replaces fuel excise over the long term.

**Simplicity and certainty**

Third, assistance should aim to be delivered as simply as possible for both the Government and the public, preferably through existing mechanisms, to minimise administrative costs and avoid new overlapping means tests.

To increase certainty, the assistance should aim to be as predictable and stable as possible. While the Scheme permit price may at times be volatile, the package should avoid ad hoc changes to tax and transfer payment settings after the initial adjustments, as such changes would increase uncertainty about the Scheme's costs and benefits.

The Government should consider implementing durable ex ante assistance rather than developing complex mechanisms, beyond the normal CPI adjustment of transfer payments, to respond to changes in the carbon price.

**HOUSEHOLD ASSISTANCE PACKAGE COMMITMENTS****July 2008 — CPRS Green Paper**

## Household Assistance Measures

The Government has committed that every cent raised for the Australian Government from the Carbon Pollution Reduction Scheme will be used to help Australians – households and business – adjust to the scheme and to invest in clean energy options.

The Government is also committed to providing low-income households with increases in assistance through the tax and payment system and all households with other assistance to address the impact on their living standards. It is committed to:

- Increase payments, above automatic indexation, to people in receipt of pensioner, carer, senior and allowance benefits and provide other assistance to meet the overall increase in the cost of living flowing from the scheme.
- Increase assistance to other low-income households through the tax and payment system to meet the overall increase in the cost of living flowing from the scheme.
- Provide assistance to middle-income households to help them meet any overall increase in the cost of living flowing from the scheme.
- Review annually in the Budget context the adequacy of payments to beneficiaries and recipients of family assistance to assist households with the overall impacts of the scheme, noting that these payments are automatically indexed to reflect changes in the cost of living.
- Provide additional support through the introduction of energy efficiency measures and consumer information to help households take practical action to reduce energy use and save on energy bills so that all can make a contribution.

The Government has indicated in the terms of reference for Australia's Future Tax System Review that it is to consider the interrelationships between the tax and transfer payment systems and the scheme.

**December 2008 — CPRS White Paper**

- Pensioners, seniors, carers and people with disability will receive additional support, above indexation, to fully meet the expected overall increase in the cost of living flowing from the Scheme
- Low-income households will receive additional support, above indexation, to fully meet the expected overall increase in the cost of living flowing from the Scheme
- Middle-income households will receive additional support, above indexation, to help meet the expected overall increase in the cost of living flowing from the Scheme. For middle-income families receiving Family Tax Benefit Part A, the Government will provide assistance to meet at least half of those costs
- Low- and middle-income working households will also receive a tax cut to assist with the expected overall increase in the cost of living flowing from the Scheme

- Motorists will be protected from higher fuel costs from the Scheme by ‘cent-for-cent’ reductions in fuel tax for the first three years
- All households will receive support to take practical action to reduce their energy use and save on energy bills
- Small businesses and community organisations can apply to receive assistance to invest in energy efficient equipment
- Australian workers will be supported through targeted assistance for industry and investment in the green economy
- The Government will review the adequacy of assistance annually to ensure households continue to receive the support they need

## Summary of revised CPRS Household Assistance Package as at November 2009

The CPRS was to be introduced on 1 July 2011 with a fixed \$10 per tonne carbon price, reverting to a flexible carbon price from 1 July 2012 (assumed to be around \$26 per tonne). The Scheme was expected to have an overall price impact on households of 1.1% over 2 years.

The assistance provided is in addition to 'cent for cent' fuel tax offsets.

### Household Assistance Package elements (over two years)

*Note: All figures are presented in annualised terms to ensure equivalent treatment of annual tax changes and fortnightly and quarterly transfer payments.*

#### 2.5% increase to pensions:

Increase in single (coupled) pension: \$455.00 (\$343.20 each)

Increase for Transition Rate pensioners to align with the 'New system' pension increase

Increase for Seniors (delivered via the Seniors Supplement) to align with pension increase

#### 2.5% increase to Parenting Payment Single

Increase in single pension: \$410.80

#### 2.5% increase to allowances

Increase for single (coupled) allowance (> 21 Newstart, no children): \$314.60 (\$286.00 each)

Increase for single allowance (> 60 Newstart or with children): \$340.60

#### 2.5% increase to max rates of FTB-A and FTB-A supplement

Increase in 0-12: \$131.40 (including FTB-A supplement)

Increase in 13-15: \$160.60 (including FTB-A supplement)

#### 5.5% increase to base rate of FTB-A (including FTB-A supplement)

Increase in 0-17 base rate (also 16-17 max rate): \$116.80 (including FTB-A supplement)

Increase in 18-24 base rate (also max rate): \$142.35 (including FTB-A supplement)

#### 2.5% increase to FTB-B

Increase in child under 5 rate: \$105.85 (including FTB-B supplement)

Increase in child older than 5 rate: \$76.65 (including FTB-B supplement)

Per-family additional supplement \$620 (increase of \$240 for 2011-12 and a further \$380 for 2012-13)

\$390 increase to LITO (increase of \$150 on 1 July 2011 and a further \$240 on 1 July 2012) and \$150 increase to Dependency Offsets (increase of \$60 on 1 July 2011 and a further \$90 on 1 July 2012).

A small number of low-income households who can show they will not be assisted in accordance with the Government's commitments will be provided with a transitional payment for the first two years of the scheme. Eligible claimants will receive a \$200 payment for 2011-12 and a \$500 payment for 2012-13.