

TREASURY EXECUTIVE MINUTE

Minute No. 20110052

10 January 2011

Deputy Prime Minister and Treasurer

CPI IMPACTS — CARBON PRICING COMPARED TO THE GST AND EXCHANGE RATE MOVEMENTS

Timing: For your information.

Issue: Your Office requested the below briefing comparing the CPI impacts of carbon pricing, the introduction of the GST and exchange rate movements.

Noted

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KEY POINTS

- Noting that these CPI estimates are uncertain and subject to revision, the following talking points could be used to publicly contrast consumer price index (CPI) impacts.

Policy design based on *Carbon Pollution Reduction Scheme (CPRS)* coverage and design

- The CPI impact of the introduction of the GST was around 7 times larger than the impact that a A\$10 carbon price is likely to have.
- The CPI impact of the introduction of the GST was around 3½ times larger than the impact that a A\$20 carbon price is likely to have.
- A persistent fall in the Australian dollar would cause import prices, and thus overall prices, to rise over time.
 - The CPI impact of a 10 per cent rise in import prices is likely to be around three times larger than the effect of a A\$10 carbon price.
 - The CPI impact of a 10 per cent rise in import prices is likely to be around 50 per cent larger than the effect of a A\$20 carbon price.

Policy design for an *electricity only* scheme

- The CPI impact of the introduction of the GST was around 9 times larger than the impact that a A\$10 carbon price applied to the electricity sector is likely have.
- The CPI impact of the introduction of the GST was around 4½ times larger than the impact that a A\$20 carbon price applied to the electricity sector is likely have.
- A persistent fall in the Australian dollar would cause import prices, and thus overall prices, to rise over time.
 - The CPI impact of a 10 per cent rise in import prices is likely to be around four times larger than the effect of a A\$10 carbon price applied to the electricity sector.
 - The CPI impact of a 10 per cent rise in import prices is likely to be around twice as large as the effect of a A\$20 carbon price applied to the electricity sector.

Caveats

- Treasury advises that significant caution should be exercised when using the talking points.
- The **carbon price** CPI estimates on which they are based are *uncertain* and will be *revised* (following the completion of updates to the macroeconomic modelling, likely to be completed in the next six months).
 - Further, the A\$10 and A\$20 carbon price CPI impact estimates have been scaled from a preliminary A\$30 carbon price modelling exercise — which found CPI impacts for the first year of operation in 2012-13 of 1.04 per cent for CPRS coverage and 0.8 per cent for electricity-sector-only coverage.
 - : This differs from the original CPRS package estimate because modelling and data updates now suggest that the CPI is slightly less sensitive to a given carbon price than previously estimated.
- In regard to the **GST**, this increased the CPI by around 2½ per cent through the year to the June quarter 2001 (close to Treasury's 2000-01 Budget estimate of an impact of 'around 2¾ per cent'). The GST was also accompanied by other tax reforms, including the abolition of the wholesale sales tax and other taxes like bank account debits tax.
- Estimating the CPI impact of **exchange rate** movements is very difficult. Many exchange rate shocks are short lived, with retailers often absorbing temporary moves in either direction.
 - The talking points are based on Treasury and Reserve Bank of Australia research which suggests that the CPI impact of rising import prices occurs over a prolonged period (over three years in the RBA research).
 - This estimate holds other effects constant, and so excludes the domestic CPI impact of events which may have driven the exchange rate movement. (For example, a commodity price rise which raises the terms of trade and thus the exchange rate also raises the price of commodities consumed domestically.)
- Tax Analysis Division, Macroeconomic Policy Division and Domestic Economy Division were consulted in the preparation of this minute.

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