

Reading *Between the Lines* this week:

1. Electricity and pricing signals ...
2. ... How is our behaviour affected?
3. The Australian home: a sacred site for tax policy?
4. The slippery slope of the war on terror

### **Electricity and pricing signals ...**

A lot of what passes for energy policy is based on the notion that higher prices will reduce demand. Unfortunately for the economic rationalists, electricity proves to be an important counter-example.

Over the last several years, electricity prices have increased well beyond inflation. Figures released as part of the Consumer Price Index data show that electricity prices increased by 63 per cent over the last decade compared with 37 per cent for the CPI as a whole.

Higher prices have not caused electricity use to fall. Figures from the Department of Environment, Water, Heritage and the Arts show residential consumption of electricity increased 25 per cent over the last decade.

People own bigger houses and have more consumer goods to fill them. Large, flat-screen TVs are power hungry, and the bigger the house, the more heating and lighting is required.

Figures from the ABS show that between 2000–01 and 2006–07, the size of newly built houses increased by 11.7 square metres. So in just those few years the average new house has grown in size by the equivalent of another bedroom. Apartments and flats are not far behind, having increased by eight square meters in the same period.

These factors drive electricity use. Price will have a marginal impact, but unless it seriously affects the whole-of-life costs of a new house or new appliance, we can only ever expect the effect to be small.

Among the policy hardheads, renewable energy targets are usually seen as the poor cousin of price-based mechanisms like the CPRS. However, in the case of domestic electricity, the evidence is clear. Price plays second fiddle to a wide range of other factors

### **... How is our behaviour affected?**

Price is only one of many factors affecting demand, including demand for energy, so climate-change policy needs to be based on a clear understanding of all those aspects of human behaviour that are not driven by price. In this country and around the world, there are millions of people taking steps (and paying money) to reduce their climate impact purely and simply because they care about the environment.

This is occurring even without a price on carbon, so one might expect the total amount of climate-friendly behaviour to increase when emissions-trading becomes law. But this would be wrong.

Research has shown that price signals can undermine intrinsic motivation to undertake a socially desirable activity such as giving blood or volunteering for charity. Somewhat counter-intuitively, introducing prices can result in less of that activity taking place, a phenomenon known as 'crowding out', since other considerations (such as money) overcome intrinsic motivation as the basis for action.

The same principle also applies to the way people consume energy. The majority of climate-friendly behaviour is voluntary rather than price-driven today. But unless climate policies are carefully designed, a carbon price could actually result in *lower* levels of climate-friendly behaviour. Worryingly, such changes in the motivational basis for individual behaviour are often *unidirectional*. In other words, once a carbon price undermines voluntary efforts, we may not be able to recapture that intrinsic motivation. Bad policies, like the proposed Carbon Pollution Reduction Scheme, cannot necessarily be reversed.

You can read more in the Institute's paper, *Zero-Sum Game? The human dimensions of emissions trading*.

### **The Australian home: a sacred site for tax policy?**

In Australia, the owner-occupied home is exempt from capital gains tax whether it is worth \$200,000 or \$20 million. Recently, a media leak suggested that the Henry Tax Review might recommend to the government that homes valued above \$2 million should be subject to capital gains tax. The Treasurer jumped on the story, saying that the government had not requested any such modelling. However, he has refused to rule out such a tax so we can presume the possibility is still on the table.

The necessity for governments to collect the revenue needed to provide essential services will not go away. The revenue forgone from not taxing capital gains on homes is \$25 billion a year according to the Treasury. As is usual in relation to wealth, most of this relates to the more valuable homes.

If homes over twice the median price—that is over \$800,000—were included in the tax base, as suggested in a recent Institute paper on capital gains tax, substantial revenues would be gained. Although the tax would catch only a minority of homes they would be the valuable ones.

Based on data on the distribution of wealth, of which homes comprise almost half, the most expensive 15 per cent of houses actually account for half of the total value of all houses in Australia. In total, the top 15 per cent of homes are worth in excess of \$1 trillion. Revenue from a tax restricted to such homes might be in the range of \$5 billion per annum, depending on the regime for phasing in the tax once the value of the home exceeded the threshold. The

Institute explored what would occur if the 50 per cent capital gains discount were to be abolished and found that this revenue estimate would double.

The current concessional tax regime for homes is grossly unfair to renters, who have to pay extra tax in consequence. Taxing capital gains on expensive homes would be a big step on the path to a fairer tax system.

You can read more in the Institute's paper, *Tax equity: reforming capital gains taxation in Australia*

### **The slippery slope of the war on terror**

In January this year, US President Obama declared an end to the 'War on Terror'. In addition to the symbolic rhetorical shift, the new administration eliminated some of the most controversial measures used by the Bush Administration, including bringing to an end the process of coercive interrogations of suspects and closing the secret CIA prisons. Yet in Australia we are heading in the opposite direction.

Picking up where the Howard Government left off, the Rudd Government is proposing to redefine terrorism to include acts of psychological as well as physical harm and to give police the power to conduct searches without warrants. In the words of the government, these measures are necessary because the country faces a 'significant threat' of attack by extremists.

The government has sought to suggest that it has got the balance right, however, by proposing to soften some of the measures introduced by the previous government. In particular, they are proposing to shorten to eight days the period that a suspect can be held without charge and to abolish the offence of sedition.

But are such 'steps in the right direction' to be applauded or decried? Surely it is an improvement that citizens can now only be held for just under eight days without charge rather than the existing uncapped period. And surely it is an improvement to remove the offence of sedition while retaining the offence of 'urging the overthrow of the constitution or government by force or violence'.

Surely not. The result of this proposal from the Rudd Government is to provide bipartisan support for the idea that citizens can be held without charge and that you can be jailed for what you say rather than what you do.

These proposals signal the death in mainstream politics of the ideals on which our legal system is built, including the presumption of innocence and the idea that the judiciary, not the police, decide whether a home is to be searched. Rather than a debate about principle, both major parties are merely haggling over price.

Instead of throwing out the Howard Government's draconian laws, the Rudd Government has watered them down in some areas and extended them in others. Although it has cited the 'significant threat' of terrorist attack, the

national threat level remains at 'moderate'. Imagine what might happen to our rights if the threat level were to rise to 'extreme'?

### **Recent publications**

- *The impact of the recession on women*
- *Zero-Sum Game? The human dimensions of emissions trading*

### **Recent media**

- Women shun promotion for sake of children, *The Australian*, at <http://www.theaustralian.news.com.au/story/0,25197,25971535-601,00.html>
- Save energy to help industry, *Sydney Morning Herald*, at <http://business.smh.com.au/business/save-energy-to-help-industry-20090811-egva.html>
- Rudd proposals urge tax on Australia's wealthiest, *Herald Sun*, at <http://www.news.com.au/heraldsun/story/0,21985,25949983-662,00.html>