



Pricing carbon pollution: Supporting and engaging low income households

Australian Council of Social Service (ACOSS)
April 2011

Summary

ACOSS supports the introduction of a carbon pricing mechanism. However, the cost of living for low income households will increase as a result of pricing carbon pollution. While the anticipated increases may be relatively modest, they are material and significant enough to bring further adversity to families and individuals who live on low, fixed or unreliable incomes.

As a matter of equity and fairness low income households should be properly assisted to meet increases in the cost of living associated with pricing carbon pollution. This assistance should be provided in ways that support the intention of a carbon price, sending signals to producers and consumers through changes in retail prices.

Assistance for households should address the range of household characteristics as far as reasonable; be paid from mechanism commencement, be indexed and adjusted annually; be reviewed and adjusted as required ahead of the transition to flexible ie market arrangements; compensate *only* for the cost impacts of a carbon price (ie not address increases in prices resulting from other factors); address *all* cost impacts from a carbon price (ie retail energy prices and others including food).

With a view to the proposed carbon pricing mechanism, assistance should be provided through a combination of:

- recurrent cash payments through the income support system (calculated as percentage or fixed dollar amounts with arrangements for review and adequate indexation);
- and
- changes to the taxation system (the personal taxation system generally, the Tax Free Threshold and Low Income Tax Offset specifically, Family Tax Benefit A, or/and Family Tax Benefit B).

While the taxation and transfer systems provide the best and fairest means to channel assistance for households, the existing systems are inequitable and inefficient and, as far as possible, the design of household assistance in parallel with a carbon price mechanism should not exaggerate these deficiencies.

In addition to adequate cash assistance, there should be a significant and sustained investment in improving energy use efficiency in low income households. Energy efficiency measures should be implemented whether funded through revenue from the carbon price mechanism or otherwise,

Finally, ACOSS seeks to ensure that the community services sector is not compromised by the introduction of a carbon price. Not-for profit providers of a wide range of critical community services are exposed to increases in the costs of basics like energy, food and fuel. Most community service providers are unable to pass through cost increases via higher charges but, instead, to seek revenue increases or reduce services.

Household assistance

ACOSS is primarily interested in and concerned about households with incomes in the two lowest quintiles of the equivalised household income distribution (as measured and reported by the Australian Bureau of Statistics). The majority of these households rely fully or partly on income support payments. See page 6 for more information.

Households in the two lowest quintiles of income are exposed to vulnerability from even small increases in the cost of essential goods and services (particularly food, fuel and utilities) and should be shielded from cost increases caused by a carbon price mechanism. Many of these households already dis-save, that is they regularly spend more than they earn.

In considering proposals for household assistance under the carbon price mechanism, ACOSS has assumed that: the taxation and transfer systems operate as currently; the assistance measures proposed are similar to the CPRS in terms of purpose and scope; there are no developments that have or will substantially affect the assumptions or outcomes of modelled impacts on cost of living; and that any proposed 'ongoing increase' i.e. above modelled cost of living increases, is paid and maintained as contemplated by the CPRS.

While cognisant of the various calls on revenue from the carbon pricing mechanism, reasonable and otherwise, ACOSS is of the view that household assistance should be prioritised and followed closely by provision for investments in clean energy technology, research and development, community and industry transition, appropriate industry assistance.

ACOSS argues that some of the revenue generated by a carbon price mechanism should flow to energy efficiency improvements, particularly for low income households.

Household assistance - The transfer and taxation systems

Previous modelling by Treasury of CPRS impacts on the cost of living, ie on household expenditure, suggested that a \$23/t CO₂/e carbon price would result in an average increase in the CPI of 1.1%. Worst case modelling was for a 1.4% increase for single pensioner and sole parent pensioner households.

Delivery of (cash) household assistance under the CPRS was framed by the tax and transfer systems (critically Centrelink-delivered pensions and allowances, Family Tax Benefit A and B, and the Low Income Tax Offset). The key household assistance measure proposed by the CPRS was the promise to lift all pensions and allowances by 2.5% from the date of scheme commencement (ie ahead of the impacts flowing through) and to review and index all payments annually. The notional 'buffer' built into the 2.5%, i.e. the 1.4% above projected average CPI increases, was to stay in place.

Now, as then, ACOSS is concerned that the current income support system is not an adequate, fair and consistent foundation for assistance, particularly following changes made to pensions over the last few years. In simple terms, pensions are now much higher than allowances (including, for example, Newstart, the unemployment benefit). ACOSS is of the view that while current levels of pension payments are still inadequate (at \$365 per week for single adults), the levels of allowance payments are now well below the poverty line and almost punitive (at \$237 per week for single adults). A single person in receipt of the Newstart allowance lives on \$34 per day, which is \$128 per week lower than for people on pensions.

Allowance recipients are not entitled to the \$10 per week 'utilities' payment (now integrated with the Pension Supplement) nor the more recent \$32 per week increase in single pension rates. Regular indexation for allowances is based on the CPI which does not adequately address cost of living changes, and is less comprehensive than the indexation arrangements for pensions, based on the Pension and Beneficiary Living Cost Index (PBLCI). This means that the 'starting

points' for compensation for pension and allowance recipients similarly affected by a carbon price are inconsistent and that allowance recipients risk being under-compensated for actual increases in their cost of living.

The CPRS proposed a simple method of assistance for households, effectively a per cent increase in pensions, allowances and tax benefits that tapered out as incomes rose. This is an administratively easy solution but it would come at a personal cost to millions of Australians. Given persistent inequities between types of base income support payments, it may be preferable to provide financial assistance through payment of additional fixed dollar amounts through pensions, allowances and benefits rather than by a percentage increases. These fixed amounts should adequately reflect the modelled and actual increases in the cost of living by household types, with an appropriate buffer. The fixed amounts should vary with regard to characteristics including household size and age of children, as well as housing status (eg private or public rental) to take account of costs variations likely to be experienced.

However, fixed amount payments should be made automatically through the existing social security system, rather than rely on those affected to apply for assistance. It is important that the cash assistance is readily available on a continuing basis to meet the range of household cost increases.

By way of example and illustration only:

If at \$25/t CO₂-e the impact on cost of living is 1.0% for an average household or about \$10 per week (assuming that fuel is excluded) and if assistance is as proposed under the CPRS ie modelled impact plus a 'buffer' to total 2.5%, the assistance for a single adult:

> *pensioner* who receives \$364.65 per week, 2.5% is \$9.12.

> *unemployed person* in receipt of Newstart at \$237.45 per week, 2.5% is \$5.90.

In both cases the assistance provided is less than the modelled average impact on household expenditure of \$10 per week. If assistance is based on household income rather than household expenditure, inequity in the transfer systems is perpetuated and exaggerated. A fixed dollar amount, including the modelled average impact plus a buffer would be more equitable.

ACOSS considers that the serious deficiencies in payment levels for allowance recipients should be addressed urgently. Recent changes to the income support system highlight continuing unfairness and inadequacy. The Henry Review recommended changes in the relativities between payments which, if implemented, would significantly redress inequities in the income support system and in future apply the same formula used to adjust single pension rates to adjust allowance payments. These recommended changes have not been implemented but should be, ahead of the commencement of the carbon pricing mechanism and in the context of the employment participation agenda.

Professor Garnaut has recently suggested that household assistance should be addressed, at least in part, through implementation of broader reforms recommended by the Henry Review ('Australia's future taxation system'). Whilst ACOSS generally supports the approach in the Henry Review, we regard this project as beyond the scope of a carbon pricing mechanism and have significant concerns about the regressive impacts of some of the recommendations, in particular to flatten the personal income tax rate scale. See *ACOSS Paper 164, Australia's Future Tax System, Tax Reform Evaluation* (5 May 2010) at http://acoss.org.au/images/uploads/Henry_Review_-_evaluation_of_tax_proposals.pdf.

As noted above, if household assistance is to be addressed through changes to the tax and transfer system, it is essential that people on the lowest incomes – pensioners, people who are unemployed and sole parent pensioners – still receive direct ie cash financial assistance. If the Government is to progress recommendations from the Henry Review, an important first step must be to implement the increase of Allowances such as Newstart by \$50 per week and adopt PBLCI as the metric for future indexation. As well as addressing the seriously and unjustly inadequate rate of this allowance this reform would have important participation benefits, especially by improving incentives for pensioners of working age to seek paid work.

If there are to be significant changes to the design of assistance measures for households, either to the scope and method of cash assistance or, for example, through implementation of reform to the personal taxation system or offers of lump sum one-off payments, ACOSS would seek to review the detail of those proposals with a view to ensuring equitable outcomes for low income households and the integrity and sustainability of both the carbon price mechanism and the taxation system.

Household assistance – Alternative mechanisms

It might be possible to design a package of assistance for households that did not rely on, or not completely, the tax and transfer systems. It might be possible to design a system of payments or rebates delivered through the Health Insurance Commission (Medicare), or delivered through energy retailers. However, it would be difficult to assure people in low income households that such arrangements are comprehensive, robust and would be sustained in future, especially given the trend towards deregulation of retail energy prices. Furthermore, any of these alternatives would likely prove unnecessarily complex (consider, for example, existing jurisdictional Community Service Obligation arrangements for energy). There is strong evidence that schemes relying on opt-in are not taken up by many people who are eligible. Recent research by the Independent Pricing Authority (IPART) in New South Wales suggests that 20% or more of households eligible for rebates on energy bills do not avail themselves of this support. By way of illustration, there are approximately 5.5 million holders of concession cards. If that were a metric of eligibility, for the sake of illustration, more than 1 million individuals with an entitlement to assistance would not avail themselves of it.

Essential goods and services – Energy and poverty

ACOSS acknowledges that the greatest contributions to cost of living increases arising from a carbon price will likely be from increases in retail prices for electricity and gas (18% and 12% respectively at \$23/t CO₂-e as modelled by Treasury for the CPRS). Over the last decade increases in retail prices for energy have outstripped the CPI and increases for other essential goods and services including food. Electricity prices have nearly doubled over the last ten years and could double again over the next five years. Increases have been driven by changes across the supply chain, from generation through transmission and distribution and by policy measures including the Renewable Energy Target. A carbon price will exacerbate these changes.

Fuel poverty and energy hardship are real issues in the Australian community. ACOSS is genuinely concerned to ensure that low income households stay on supply and have access to affordable energy. Price rises resulting from a carbon price, in conjunction with other factors, may have the effect of increasing the number of households experiencing energy hardship and the number of disconnections. However, the carbon price mechanism should not be regarded as the cause of all energy price increases, nor as a panacea for them.

We note that there is currently a disparate range of energy-specific concessions measures administered by the states and territories. The scope, adequacy and delivery mechanisms for these measures vary significantly. Similarly, energy retailers currently offer a range of hardship and other customer support programs and the scope, adequacy and delivery mechanisms for these measures vary significantly. The implementation of a National Energy Customer Framework may go some way towards inter-jurisdictional harmonisation and enhancement of measures. Increased revenue to states and territories from increased GST takes and increased revenue to retailers from margins on higher energy bills may assist in the provision of appropriate assistance. Energy hardship is, however, a significant looming issue with the potential to further disadvantage low income households.

Low and middle incomes

The document issued by the MPCC 24 February 2011 reiterates one of the previously agreed (in December 2010) principles and notes that "... the introduction of a carbon price will affect Australian households and communities, but that assistance should be provided to those... most needing help to adjust...". In its original form that principle went on "... while striving to maintain incentives to change behaviour and reduce pollution".

The CPRS White Paper set out income thresholds for various household types, low-, middle- and high-income, as below.

Household type	Low income (less than) \$	Middle income (between) \$	High income (above) \$
Single person	30,000	30-80,000	80,000
Couple, no children	45,000	45-120,000	120,000
Couple, with children	60,000	60-160,000	160,000
Single parent	60,000	60-160,000	160,000

For the sake of illustration and comparison, these levels of annual income translate to the following levels of weekly income.

Household type	Low income (less than) \$	Middle income (between) \$	High income (above) \$
Single person	576	576-1,536	1,536
Couple, no children	864	864-2,303	2,303
Couple, with children	1,152	1,152-3,071	3,071
Single parent	1,152	1,152-3,071	3,071

ACOSS defines 'low income' differently, as the two lowest quintiles of income. The Australian Bureau of Statistics¹ reported in 2009 on 2007-08 income estimates from the Survey of Income and Housing. The mean income in each quintile is set out below. Note that the ABS found that "average (mean) equivalised disposable income for all persons living in private dwellings (ie the income that a single person would require to maintain the same standard of living as the average person living in all private dwellings in Australia was \$811 per week." The current rate of payment (in 2011 dollars) for a single adult in receipt of Newstart is \$237 per week. Note also that although the figures below indicate the mean gross income in each quintile, the income at the top of the second quintile was \$1,007 suggesting that any income below that low level could be regarded as 'low'.

	Income per week (mean) \$ *	Principal source of income - Government % **	Housing tenure - Renter % ***
Highest quintile	3,922	0.0	22.9
Fourth quintile	1,947	0.5	28.6
Third quintile	1,287	2.3	28.4
Second quintile	759	23.9	30.7
Lowest quintile	332	73.3	36.5

¹ Australian Bureau of Statistics, Household Income and Income Distribution 2007-08, August 2009

- * Gross income
- ** Government pensions and allowances
- *** Includes public, private and other

One implication of earlier framing for the CPRS was that households on what some might regard as [relatively] high incomes eg up to \$200,000 per annum (dual income, two children) would receive assistance (of \$390 p/a to offset modelled cost increases of \$1460 p/a). It might be argued that there are different understandings of (and thus thresholds for assessments of) low and middle income. For example, it is likely that some households compensated under the previous model would fall within the top quintile of the household income distribution.

Concerns about modelling

ACOSS notes the following concerns that should be addressed in Treasury modelling before the design of household assistance is finalised:

- (1) Cost to scheme revenue: changes to key assumptions since the Treasury modelling was published in 2008 include the numbers of recipients of the range of pensions, allowances and benefits and the rates at which those pensions, allowances and benefits are paid.
- (2) Previous Treasury modelling assumed that east coast gas prices would head to international parity over a 20 year period. A range of factors including a/the carbon price mechanism may affect (increase) gas prices more quickly leading to higher prices for retail gas and also electricity.
- (3) Modelling assumptions regarding household saving and spending patterns are critical to the outcomes. It is vital that dis-saving among low income households and the different spending patterns among different household types and income levels are taken properly into account.

Transition arrangements: from fixed price to cap and trade ('flexible')

ACOSS is concerned that the transition from a fixed price to a flexible price could have significant adverse consequences for people in low income households. We recommend that the process to address the impact on households of the transition to a flexible price be legislated and completed well before the transition takes place. The process to address impact should be conducted in two parts:

- (1) an assessment of the actual impacts of the fixed price (ie over the period in which the fixed price mechanism has been in place) and the adequacy of assistance measures; and
- (2) an assessment of the likely impacts of a flexible price and whether assistance measures require adjustment to appropriately compensate for any change.

If there is any chance of a step-change in cost of living as a result of the transition, it should be met with a timely and comprehensive step-change in assistance. This review, and its methodology, should be legislated well in advance and ideally be part of the primary design of the carbon pricing mechanism.

Energy efficiency

Energy use-efficiency is a significant issue for low income households as a result of poor quality housing stock (low thermal quality public and private rental stock that is generally beyond the control of occupants), and limited potential to improve use efficiency with better appliances (limited cash in hand at time of purchase). ACOSS is supportive of schemes that:

Australian Council of Social Service (ACOSS)

- (1) make cost effective improvements to housing stock, appliances and use;
- (2) increase mandatory efficiency of appliances (with a view to equity and affordability);
- (3) provide information about the efficiency of homes at sale and lease;
- (4) regulate planning and building to improve efficiency and affordability; and
- (5) invest in solar and other technologies when and where cost effective.

Improvements to energy efficiency should include, for example, a well-managed home insulation program. Our preference is for a coordinated approach to households involving efficiency assessments, plans for improvements linked to programs that implement improvement (insulation, appliances etc) and address use (behaviour). Programs must address the 'split incentive' in ways that encourage landlords to allow or invest in improvements without increasing rents.

There are currently no federally funded, federally mandated, federally consistent household energy efficiency schemes in operation. ACOSS has previously called for significant investments in improved energy efficiency to begin ahead of the introduction of a carbon price. Improved energy efficiency can improve well-being, contribute to the carbon pollution mitigation effort, can in effect be adaptive to climate change, and can save occupants money by minimising energy consumption and expenditure on bills.

Some of the revenue generated through a carbon pricing mechanism should be invested in improving residential energy efficiency, particularly for low income households. In addition to beneficial outcome for householders such an investment has the potential to grow enterprises and jobs. See further *ACOSS Paper on Energy Efficiency* (forthcoming)

Inequitable policy and programs

All policy and programs developed in response to climate change should pass a fairness and equity test as well as effectiveness and cost effectiveness tests.

Counter-productive policy

A range of current Commonwealth taxation and spending measures are, in effect, contrary to the objectives of a carbon pricing mechanism and should be ended.

Any assistance to industry and business should be commensurate with the impacts of the scheme and not contrary to the intent of the scheme and other policy.

Community sector

The community service sector includes, for example, aged care, child care, services for people with a disability, meals on wheels and other in-home assistance. These services are a critical feature of Australian society and complement the system of benefits and allowances. These services are of particular importance to low income, disadvantaged and vulnerable individuals and households, many of whom have no, or very limited, capacity to pay for the services they use. Any diminution in the quantity or quality of these services impacts directly and immediately on individuals and households living in poverty and on low, fixed income households.

The Government must ensure that increases to operating costs resulting from a carbon price do not adversely affect the capacity of government agencies, non-government organisations and others to deliver services in support of low income households and the community at large. Investments in improved energy use-efficiency for the community service sector may, over time, ameliorate the impacts of price increases for services and goods essential to operations, including energy and fuel.

Principles

- (1) The Government must guarantee that no group of people on low incomes will be financially worse off from putting a price on carbon pollution. In addition, to the extent that low income households improve their energy efficiency, there should be a financial incentive to do so i.e. cash assistance should not be affected.
- (2) The Government should provide adequate and appropriate cash assistance to the lowest income households, including pensioners, people who are unemployed and sole parent pensioners.

This financial assistance should be paid through the social security and taxation systems and take account of the average price increases facing various types of households (for example, single pensioners and single unemployed people by household income bracket) without distorting fair relativities between social security payments.

The starting point for financial assistance through the income support system should be the highest average price increase affecting a substantial group of recipients, together with a significant buffer to account for above-average household price impacts and potential distortions in modelling and forecasting. This is the conventional approach to compensating low income households for the price impacts of Government policies. Assistance should be based on the total levels of income support and other statutory Government cash benefits paid to recipients, including supplements such as Rent Assistance and Mobility Allowance.

- (3) If financial assistance to households generally is to be implemented in conjunction with broader tax reform, a first priority should be to implement the proposal by the Henry Review to substantially reduce the gap between Allowance payments and pensions (currently \$128 per week, and increasing). The Government should benchmark the single rate of Allowance payments at the same proportion of the partnered rate that applies to pensions. At present, this requires that the single rate of the Newstart Allowance should be increased by approximately \$50 and its indexation benchmarked with pensions. See *ACOSS Paper, 6 Good Reasons to increase the Newstart Allowance* (2011, forthcoming). Further, a common system of indexation should apply, including indexation to wages and the PBCLI to both pensions and allowances.
- (4) The Government should introduce measures to significantly increase the efficiency of energy use in households, especially low income households, with a view to maximising amenity from energy consumed, minimising consumption and energy bills, and reducing carbon pollution. See separate *ACOSS Paper on Energy Efficiency* (forthcoming). ACOSS believes that energy is an essential service and that a reliable and affordable supply of energy must be guaranteed as far as reasonably possible. The regulation of Australian energy markets should ensure fair and affordable household tariffs for basic levels of consumption.
- (5) The Government must ensure that cost increases resulting from a carbon price do not adversely affect the capacity of the community sector to deliver services in support of low income households and the community at large.